1992

Arco Electric v. Utah State Tax Commission : Brief of Appellant

Utah Supreme Court

BRIEF

IN THE SUPREME COURT

OF THE STATE OF UTAH

ARCO ELECTRIC, Petitioner below and on Appeal, v. UTAH STATE TAX COMMISSION, Respondent below and on Appeal.	Supreme Court Case No. 920182

BRIEF OF APPELLANT ARCO ELECTRIC (WITH RESPECT TO GRANITE SCHOOL DISTRICT RELATED ASSESSMENT)

Petition for Review of Final Decision of Utah State Tax Commission

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LIST OF PARTIES

The parties directly involved are Arco Electric, Inc., Petitioner, and the Utah State Tax Commission, Repondent. However, the appeal involves sales taxes, the incidence of which will fall on Granite School District and the Corporation of the Presiding Bishop of The Church of Jesus Christ of Latter-day Saints. At the Tax Commission level, this case also involved sales taxes which would have fallen on the Utah Transit Authority, but those were decided in favor of Arco and Utah Transit Authority and no appeal of that portion of the case has been made. The issue to be decided is also material to other cases filed before the Tax Commission and the Supreme Court by other petitioners and involving other tax-exempt entities, the exact identities of which are not all known to Petitioner.

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JURISDICTION

This Court or the Court of Appeals has jurisdiction to review the Utah State Tax Commission's decision in this matter pursuant to Utah Code Ann. §63-46b-16.

ISSUES FOR REVIEW AND STANDARD OF REVIEW

(a) Issues for Review:

1. Whether Granite School District's ("Granite") purchases of materials to be installed in the construction of two school buildings by a subcontractor (Arco), were subject to sales or use tax.

2. Whether the activities of Granite must rise to the level of a "real property contractor" before its purchases of materials for use in the construction of school buildings can qualify for exemption from sales and use taxes.

3. Whether the act of installation by Arco of materials purchased by Granite into school buildings constitutes a taxable event for sales or use tax purposes.

4. Whether the Tax Commission findings and conclusions that Arco was the purchaser, owner and consumer of materials purchased and furnished by Granite was supported by the evidence and law.

(Additional issues for review have been identified in the companion brief of Arco with Respect to the LDS Church Related Assessment.)

(b) Standard for Review: This appeal presents questions of law and questions of law and fact. Arco submits the Tax Commission has (1) erroneously interpreted and applied the law, (2) taken action contrary to its own rules and (3) taken action contrary to the Tax Commissions prior practise without any fair and rational basis for the inconsistency. Thus, the applicable standard of review is the correction-of-error standard. Bevans v. Industrial Commission. 790 P.2d 573, 576 (U. App. 1990). Accordingly, the Court should review the Tax Commission's ruling for correctness but accord no deference to the Tax Commission's interpretation of the law. This Court is free to render an independent interpretation of the questions of law at issue in this case. See Morton Int'l, Inc. v. Auditing Division of Utah State Tax Comm'n, 814 P.2d 581 (Utah 1991); Savage Indus. Inc. v. Utah State Tax Comm'n, 811 P.2d 664 (Utah 1991); Ron K. Case Roofing & Asphalt Pavings, Inc. v. Blomquist, 773 P.2d 1382 (1989); Mountain Fuel Supply Co. v. Salt lake City Corp., 752 P.2d 884 (Utah 1988); Creer v. Valley Bank & Trust Co., 770 P.2d 113 (Utah 1988); Oates v. Chavez, 749 P.2d 658 (Utah 1988); and Bailey v. Call, 767 P.2d 138 (Utah Ct. App.

1989). As for any factual findings of the Tax Commission, the standard of review is whether the finding is supported by substantial evidence. Morton International, Inc. v. Auditing Division of the Utah State Tax Commission, supra.

DETERMINATIVE LAW

The decision of that portion of this case relating to Granite depends upon the interpretation of the following statutes and Tax Commission rules.

(a) Statutes: The principal statutes are Utah Code Ann. §§ 59-12-103(1)(a) and 59-12-104(2) set forth below:

59-12-103(1)(a):

> (1) There is levied a tax on the purchaser for the amount paid or charged for the following:
>
> (a) retail sales of tangible personal property made within the state;

59-12-104(2):

> The following sales and uses are exempt from the taxes imposed by this chapter:
>
> (2) sales to the state, its institutions, and its political subdivisions;

Also relevant are the definitions found in Utah Code Ann. § 59-12-102(8) and (10). That section and the complete text of

each of the statutes and rules cited herein are set forth in Addendum A.

(b) Rules:

(1) Tax Commission Rule R 865-19-42S (Utah Administrative Code):

> Sales to the State of Utah and its Subdivisions Pursuant to Utah Code Ann. Section 59-12-104.
>
> Sales made to the state of Utah, its departments and institutions or to its political subdivisions such as counties, municipalities, school districts, drainage districts, irrigation districts, and metropolitan water districts are exempt from tax if such property for use in the exercise of an essential governmental function. If the sale is paid for by a warrant drawn upon the state treasurer or the official disbursing agent of any political subdivision, the sale is considered as being made to the state of Utah or its political subdivisions and exempt from tax.

Utah Administrative Code R865-19-42S.

(2) Tax Commission Rule R 865-19-58S:

> Materials and Supplies Sold to Owners, Contractors and Repairmen of Real Property Pursuant to Utah Code Ann. Sections 59-12-102 and 59-12-103.
>
> 1. The person who converts the personal property into real property is the consumer of the personal property since he is the last one to own it as personal property.
>
> . . . .
>
> 4. Sales of materials to religious or charitable institutions and government agencies are exempt only if sold as tangible personal property and the seller does not install the material as an improvement to realty or use it to repair real property.

Utah Administrative Code R865-19-58S(A)(1) and (4).

STATEMENT OF CASE

(a) Nature of Case and Disposition: This case started with a 1987 audit of Arco by the Tax Commission's Auditing Division. On July 30, 1987, Arco was assessed sales tax on electrical materials installed by Arco under contracts or subcontracts involving three separate owners: (1) the LDS Print Center constructed for the Corporation of the Presiding Bishop of the Church of Jesus Christ of Latter-day Saints ("LDS Church"), (2) a physical facilities building constructed for the Utah Transit Authority ("UTA") and (3) two elementary school buildings constructed for the Granite School District ("Granite"). (The LDS Church, UTA and Granite will collectively be referred to as the "Owners".)

These three construction projects were separate and distinct from each other. Separate contract documents were entered into for each project between the Owners and a general contractor or subcontractor. Arco's common thread in these three projects was that Arco installed materials in each project and Arco was assessed sales tax with respect to materials purchased by each of these entities. Under each of the separate contracts, the Owners reserved the right to purchase materials to be incorporated or installed in the projects.

The Owners are all tax-exempt entities, the LDS Church is a religious and charitable organization and UTA and Granite are political subdivisions of the State of Utah.

The materials installed by Arco which are at issue in this case were purchased directly by the Owners from vendors other than Arco. No sales tax was paid on those purchases. The title to those materials passed directly from the vendors to the Owners, and the vendors looked solely to the Owners for payment of the materials purchased.

Arco filed a timely petition for redetermination of the assessment. At the formal hearing on the petition held on August 27, 28 and 29, 1991, Arco contended that the Owners were the purchasers of the materials and no sales tax was owing because sales to religious and charitable organizations and political subdivisions are exempt from sales tax by statute. Even though the assessment was made against Arco, the real parties in interest are the Owners because the burden of the assessment will pass to them.

At the formal hearing, the Auditing Division of the Tax Commission contended that because Arco installed the materials into the physical structures, Arco should be considered to have used or "consumed" the materials, and based on such use Arco was deemed the purchaser of those materials.

In its Findings of Fact, Conclusions of Law and Final Decision dated March 10, 1992 ("Findings"), the Tax Commission concluded that if a tax-exempt entity makes a purchase of an item for conversion to real property by another person or entity, the purchase is not exempt from sales and use tax because the person who converts the item to real property is the consumer of such item. The Commission's Final Decision is attached on Addendum B. The Tax Commission further concluded that the overall activities of the tax-exempt entity must rise to the level of a "real property contractor" before the purchase of an item by the tax-exempt entity for conversion to real property would be exempt from sales or use tax.

In applying these conclusions to the three separate construction projects at issue, the Tax Commission ruled that the activities of UTA rose to the level of a "real property contractor" but that the activities of the LDS Church and Granite did not. That portion of the sales tax assessment against Arco which was attributable to purchases by UTA was accordingly abated while that portion of the assessment attributable to purchases made by the LDS Church and Granite was upheld.

This petition for review relates only to that portion of the assessment attributable to purchases made by the LDS Church and Granite. Because the fact situation, contract

documents and applicable law relating to these two remaining projects are different, two separate briefs are being filed, one relating to that portion of the assessment attributable to purchases made by the LDS Church and this brief relating only to that portion of the assessment attributable to purchases made by Granite. Granite, however, joins in the arguments set out in the argument portion of the LDS Church's brief.

(b) Statement of Facts (with Respect to Granite Related Assessment):

1. The taxes at issue are sales and use taxes for the period commencing January 1, 1982 to March 31, 1987. Findings p. 7.[1/]

2. Granite is a political subdivision of the State of Utah. Id. p. 7.

3. Westbrook Elementary School and Valley Crest Elementary School ("the schools") were constructed pursuant to an agreement between Granite and Broderick & Howell

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1/ References to the record will be to the Commission's Findings of Fact, Conclusions of Law, and Final Decision ("Findings" or "Conclusions") attached as Addendum B; the Stipulation of Facts entered into by Granite and the Audit Division; and the Transcript ("Tr."). The hearing relating to Arco lasted three days, August 27, 28 and 29, 1991. August 27th related to the UTA. August 28th addressed Granite and August 29th dealt with the LDS Church. Unless otherwise indicated all transcript references are to the August 28th transcript.

Construction Company (hereinafter Broderick & Howell) dated July 18, 1984 (the "Agreement"). Id. p. 7.

4. Broderick & Howell was selected by Granite as the general contractor after submission of bids by Broderick & Howell and other contractors for the construction of the schools. Id. p. 7. Such bids were submitted after review of architectural plans, bid specifications, general and supplementary general conditions and other documents. Stipulation of Facts. p. 2. Tr. pp. 100, 119-120.

5. Granite's right to purchase materials and equipment used in the construction of the schools is set forth in the Supplementary General Conditions which were made available to all general contractor and subcontractor bidders on the project prior to the actual bidding process. The Tax Commission relied exclusively on some of these provisions in arriving at its decision. Accordingly those provisions are summarized in detail:

a. The bid price submitted by the contractor included all labor, plant, materials, equipment, transportation, services and any other items required for construction and completion of the project.

b. The contractor and any subcontractors agreed to allow Granite as owner to purchase directly any part

or all of the materials and equipment which would become a part of the schools.

c. The contractor would negotiate, and administer all direct purchases by Granite and furnish to Granite a description, source of supply and other information necessary to enable Granite to purchase directly the materials and equipment.

d. Purchases by Granite would be made on requisition or purchase orders furnished by Granite and signed by Granite's purchasing agent.

e. Title to all materials and equipment purchased by Granite passed from the vendor directly to Granite upon delivery to the job site without any vesting in the contractor.

f. After delivery, the risk of loss, damage, theft, vandalism, or destruction of or to the materials and equipment purchased directly by Granite were to lie with the contractor.

g. Storage of any materials and equipment furnished by Granite was the responsibility of the contractor.

h. The contractor was required to hold Granite harmless of and from any failure of the materials or

equipment purchased by Granite which resulted in any loss, claim, defect, discrepancy, delay in delivery or any problem relating to the materials or equipment.

i. The contractor was required to acknowledge receipt and approval of any materials or equipment purchased directly by Granite by signing the invoice for those materials or equipment.

j. Granite was required to make payment for those materials and equipment within a reasonable time after the receipt of the signed invoice from the contractor.

k. Granite was not responsible for the loss of any prompt payment discount from the purchase price if the owner made payment within ten business days following the receipt of the signed invoice from the contractor.

l. The contract price was reduced by the amount actually paid by Granite for the materials and equipment purchased directly by Granite and by the sales tax which would have been paid on such materials and equipment had they been supplied by the contractor. Similarly, the amount of any progress payment was

adjusted to reflect the direct purchase of materials and equipment by Granite.

m. Granite was not responsible for the loss or reduction of any trade discounts available to the contractor as a result of any purchases made by Granite.

n. All bonds and insurance called for in the Agreement remained in full force. No reduction in the amount of coverage or any deduction for premiums for those bonds and insurance was authorized in the Agreement.

o. The provisions for direct purchase by Granite of materials and equipment did not relieve the contractor of any of its duties or obligations under the Agreement or constitute a waiver of any of Granite's rights. Findings pp. 9-10.

6. Arco was a subcontractor of Broderick & Howell and performed electrical subcontract work pursuant to two separate Subcontract Agreements with Broderick & Howell. Both Subcontract Agreements are identical. Id. p. 10.

7. The General and Supplementary General Conditions between Granite and Broderick & Howell were

incorporated into the subcontract agreements between Arco and Broderick & Howell by reference. Id. p. 10.

8. Unrefuted testimony at the hearing demonstrated that the actual conduct and practices of the parties clarified gaps or ambiguities in the contract language and in some respects varied from the contract language. Some examples include:

(a) Broderick & Howell received, with Granite's consent, a refund on the performance and payment bond premium to reflect the reduction in the total amount of the contract attributable to the amount of materials purchased by Granite even though the contract did not provide for such a reduction. Tr. pp. 143, 150-151, 170.

(b) Risk of loss for materials purchased by Granite was covered under an insurance policy maintained by Granite even though the agreement placed risk of loss on Broderick & Howell. Findings p. 12. In fact, when a theft of electrical materials from the jobsite actually occurred, Granite's insurance carrier covered the loss. Tr. pp. 47-48, 131.

(c) The parties considered their relationships and obligations different with respect to

materials purchased by Granite as compared to materials purchased by Broderick & Howell or Arco even though the contract provisions suggested otherwise. Tr. pp. 41, 42, 44, 49, 126, 128, 130, 131, 132, 142, 147, 168, 176. Many of these differences are explained in more detail below.

9. Pursuant to the Agreement, Granite elected to purchase and furnish certain electrical materials and equipment incorporated into the schools by Arco. Findings p. 10.

10. Materials and equipment Granite elected not to purchase were purchased and furnished by Broderick & Howell or Arco or other subcontractors and sales tax was paid on such materials. Id. p. 10; Tr. p. 40.

11. With respect to materials and equipment elected to be purchased and furnished by Granite, Broderick & Howell would prepare and deliver to Granite a requisition form identifying materials and equipment and the suggested suppliers of the materials and equipment. Findings p. 10-11.

12. Granite was free to purchase the materials and equipment from suppliers identified by Broderick & Howell or from other suppliers. Tr. pp. 38-39, 130.

13. When the requisition form was received by Granite, a purchase order was then issued by Granite to the supplier selected by Granite. Findings p. 11; Tr. pp. 38-39, 130. The purchase order contained a certification from Granite that the items purchased would be used in an essential government education function and were exempt from sales and use taxes, citing sales tax regulations R865-19-42S (Utah Administrative Code) as authority. Tr. p. 16.

14. When the materials and equipment were delivered to the job site address, the supplier sent an invoice for the materials and equipment to Granite in care of Broderick & Howell for approval and payment. Findings p. 11.

15. The authorized agent of Broderick & Howell would acknowledge receipt and approval of the materials and equipment identified in the invoice by signing the invoice and then forwarding it to Granite for payment. Id. p. 11. Invoices for electrical materials purchased by Granite to be installed by Arco were not sent to Arco nor did Arco sign off on such invoices. Tr. p. 81.

16. With respect to signing off on invoices sent by suppliers of materials purchased by Granite, Broderick &

Howell considered itself Granite's agent in verifying that the invoice items had been delivered and met specifications. Id. p. 125. Granite had the power to pay any invoice without signing off by Broderick & Howell. Id. p. 142.

17. Once approved by Granite for payment, the invoice would then be paid by a Granite check drawn on the operating account of Granite by the disbursing agent of Granite. Findings p. 11.

18. After Granite made payment for the materials and equipment, a change order to the Agreement with Broderick & Howell was executed giving Granite credit for the cost of the materials and equipment purchased by Granite plus the sales tax savings associated with the materials and equipment. Id. p. 11.

19. The change order had the effect of an amendment to the Agreement removing the amount of the directly purchased materials from the Agreement. Tr. p. 107-108, 127, 134.

20. Suppliers and vendors of materials purchased directly by Granite looked solely to Granite for payment and not to either Broderick & Howell or Arco. Tr. pp. 15-16.

21. Neither Broderick & Howell nor Arco considered themselves liable in any manner to a vendor or

supplier if Granite failed to make payment for materials purchased directly by Granite. Tr. pp. 41, 128.

22. Granite had no authority to bind Arco or Broderick & Howell to any purchase obligations incurred by Granite with respect to materials purchased directly by Granite. Tr. pp. 42, 128.

23. Granite employed M.H.T. Architects, Inc. to provide various professional services with respect to the construction of the schools, including the observation of installation and construction efforts, testing of material, approval of change order(s) and the ability to stop the construction process at any time. Findings pp. 11-12; Tr. pp. 103-105. To perform these duties, M.H.T. would visit the job site on a frequent basis. Tr. p. 103.

24. M.H.T. had no contractual relationship with Broderick & Howell or Arco, Findings p. 12, and was designated as Granite's agent in the Agreement. Stipulation of Facts, Exhibit A pp. 4-6.

25. Through its contract with Granite, M.H.T. would hire engineering consultants to inspect materials furnished to the job site for installation and to test and inspect installation and construction work performed. Tr.

p. 174. Such consultants reported directly to M.H.T. or Granite and not to Broderick & Howell or Arco. Tr. p. 174.

26. In addition to the agent and supervising activities of M.H.T., Granite had a full time employee who was a construction inspector who visited the job sites on a daily basis to check on progress, inspect materials and generally observe conditions. That employee would report back to his supervisor and Granite's administration. Tr. pp. 172-173.

27. Another employee of Granite with an architecture degree and background periodically inspected the job sites, received reports from the construction inspector described in Fact 26 above and communicated with M.H.T. Id. pp. 171-172.

28. Granite maintains its own security department and during the construction of the schools, the security department patrolled the job sites and security around the job sites was increased. Id. pp. 172-173.

29. At all times during the installation and construction process and pursuant to the Agreement, Granite maintained a general liability insurance policy covering among other things, theft, vandalism and casualty losses

from materials and equipment purchased by Granite and used in the construction of the schools. Findings p. 12.

30. During the course of construction of the schools, electrical materials purchased by Granite and stored at the job site were stolen from the job site and Granite's insurance carrier covered the loss. Tr. pp. 47-48 and p. 131.

31. Granite also maintained a fire and extended coverage insurance policy in the amount of the insurable value of the schools. Findings p. 12.

32. Insurance maintained by Broderick & Howell and Arco covered general liability only and did not cover risk of loss or liability with respect to materials purchased by Granite. Tr. pp. 46-47, 130-131.

33. Lien waivers were secured by Broderick & Howell with respect to materials and equipment furnished by Arco or by Broderick & Howell. Findings p. 12.

34. Lien waivers were not secured by Broderick & Howell or Arco for materials and equipment furnished by Granite. Granite's cancelled checks were accepted in place of lien waivers. Id. p. 12.

35. Any excess materials purchased by Granite were the property of Granite, Id. p. 12, whereas Broderick &

Howell testified that any excess material purchased by it belonged to it. Tr. p. 147.

36. Materials purchased directly by Granite for installation into the schools were delivered to the job site and not to Broderick & Howell or Arco. Tr. pp. 14, 122.

37. Materials purchased directly from suppliers were paid for in full by Granite without any 10% retainage. Id. p. 15.

38. At no time during construction did Arco or Broderick & Howell consider Granite as their agent to purchase materials for installation into the schools. Id. pp. 42, 128.

39. Materials purchased by Granite and delivered to the job sties for incorporation into the schools remained the property of Granite. Arco or Broderick & Howell had no right to remove the items from the job site or use them in other projects. Id. pp. 44, 130.

40. However, Arco could remove materials purchased by it from the job site and replace them with comparable materials. Id. p. 45.

41. All manufacturer and supplier warranties on materials purchased directly by Granite ran directly to

Granite rather than to Arco or Broderick & Howell. Id. pp. 132-133.

42. The duties of Broderick & Howell under labor or installation only contracts entered into by Broderick & Howell with other owners with respect to materials supplied or furnished by the owner for installation have been essentially the same as under the Agreement with Granite. Id. pp. 138-139.

43. If a problem developed with respect to materials purchased by Granite and installed by Arco or Broderick & Howell, Granite would attempt at its expense to identify the source of the problem such as a defective item or unsatisfactory workmanship and then pursue the appropriate supplier or installer to rectify the problem. Id. p. 168.

44. With respect to materials purchased by Granite, Arco or Broderick & Howell considered themselves liable to Granite for defective workmanship but not for defective materials. Id. pp. 49, 132-133.

45. Granite considered itself more vulnerable to liability for materials purchased by Granite than materials purchased by Broderick & Howell or Arco. Id. p. 175.

46. Granite has used the direct purchase program described above for approximately 10-15 years with the understanding the program complied with applicable sales tax rules and regulations. Id. p. 169-170.

47. Other tax-exempt entities have followed substantially the same direct purchase procedures as Granite and vendors and suppliers are aware of such procedures. Id. pp. 19, 28.

SUMMARY OF ARGUMENT

The direct purchase procedures used by Granite in this case to qualify for exemption from Utah sales and use taxes comply with the governing statute, the Tax Commission's own rules, and follow the guidance of this Court. Sales of tangible personal property to Granite, as a political subdivision of the State of Utah, are specifically exempt from sales and use taxes by statute. Because Granite purchased and paid for the subject materials which were incorporated into the schools owned by Granite, the sale of the materials was specifically exempt under the Tax Commission's own rule (Rule 42S infra).

The Audit Divisions assessment against Arco was inappropriate because Arco neither purchased nor owned the subject materials. A contractor or subcontractor such as Arco

cannot be the consumer of materials incorporated into real property facilities unless it is also the purchaser and owner of such materials.

In prior cases, this Court has stated that if a political subdivision or other tax-exempt entity wishes to receive the benefits of the exemption with respect to materials used in the construction of real property facilities, it should purchase the materials directly or appoint the contractor as its agent. Granite's direct purchase procedures have followed such guidance.

While Granite assigned to the general contractor certain bailee and agency responsibilities, the most significant benefits and burdens of ownership of the materials rested with Granite. Granite was both the title and real owner of the materials.

The Tax Commission's inconsistency regarding these issues is evident in its own contradictory conclusions of law and in its contradictory decisions in essentially identical cases before it. No fair or rational basis has been presented for this inconsistency.

ARGUMENT

Under Utah's statutory governmental exemption, Utah Code Ann. §59-12-104(2), the Tax Commission's own rules and Utah case law, the purchases made by Granite were exempt from Utah sales and use taxes.

A. MATERIALS PURCHASED AND FURNISHED BY GRANITE FOR INCORPORATION INTO SCHOOL BUILDINGS ARE SALES TAX EXEMPT IF PAID FOR BY GRANITE REGARDLESS OF WHO INSTALLS THEM.

Since the 1930's Utah law has imposed a tax on retail sales of tangible personal property. See Utah Code Ann. §59-12-103(1)(a).[2/] The Code defines a retail sale as every sale by a retailer or wholesaler to a user or consumer and not for resale. Id. §59-12-103(1)(a). The materials at issue in this case were purchased by Granite directly from the vendors of the materials for Granite's use in the construction of school building facilities. Granite also directly paid the vendors by check drawn on its operating account. Findings p. 11. Thus, under Utah's general sales tax framework, the purchase by Granite of tangible personal property materials for use in school

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2/ The assessment at issue covers the period January 1982 through March 1987. The relevant statutes were recodified and renumbered in 1987. Because the substantive provisions of the code did not change, Granite cites to the current code sections (1987 and Supp. 1991) rather than the prior sections.

building construction would be subject to Utah sales tax. However, the Code exempts from tax sales of tangible personal property "to the state, its institutions and political subdivisions." Id. §59-12-104(2). This exemption is sometimes referred to as the "governmental exemption." Thus, but for the governmental exemption, the sale of materials to Granite in this case would be subject to Utah sales tax. The obvious legislative intent in the statutory governmental exemption is that purchases made by a political subdivision such as Granite be sales tax free. This legislative intent is also evident in the Tax Commission's Rule regarding Utah Code Ann. §59-12-104 which provides:

> A. Sales made to the state of Utah, its departments and institutions or to its political subdivision such as counties, municipalities, school districts, drainage districts, irrigation districts, and metropolitan water districts are exempt from tax if such property [sic] for use in the exercise of essential government function. <u>If the sale is paid for by a warrant drawn upon the state treasurer or the official disbursing agent of any political subdivision, the sale is considered as being made to the state of Utah or its political subdivisions and exempt from tax.</u>

Utah Administrative Code, R865-19-42S ("Rule 42S") (emphasis added.)

Although an "essential governmental function" requirement for the exemption is not imposed by statute, nor is it defined in the Rule, there is no question that materials

purchased and used by Granite in the construction of the schools constitutes an exercise of an essential governmental function. Because the sale of materials at issue was made to Granite and paid for by Granite by a warrant [check] drawn upon by the official disbursing agent of Granite, the sale of the materials to Granite is exempt from sales tax under the Commission's own rule. Id.

Under the Commission's rule, it is immaterial if the materials were installed by someone other than Granite or if Granite, by contract, assigned some responsibilities with respect to such materials to someone else. All that is necessary for this governmental exemption to apply is that the sale be made to Granite for use in an essential governmental function and paid for by Granite. Thus, the Tax Commission's decision with respect to Granite is contrary to its own rule and to the statutory language granting the governmental exemption.

Granite has relied on this statutory governmental exemption and the Commission's Rule 42S in its construction of new buildings. Reference to Rule 42S was specifically made in the purchase orders used by Granite to purchase the subject materials as a basis for claiming the exemption. Tr. p. 16.

If the Commission no longer believes that Rule 42S is valid or does not mean what it says, it should take appropriate

rule making or legislative steps to repeal or modify it. Until such steps are taken, Granite and other political subdivisions should have the right to rely on the clear language of the rule.

B. ARCO SHOULD NOT BE TAXED ON THE PURCHASE OF MATERIALS BECAUSE ARCO NEVER PURCHASED OR OWNED THE MATERIALS.

In upholding the Granite-related assessment against Arco, the Commission ignored Section 59-12-104(2) of the Utah Code and its Rule 865-19-42S. Instead the Commission relied substantially on its interpretation of Rule 865-19-58S ("Rule 58S") which provides in relevant part:

> 1. The person who converts the personal property into real property is the consumer of the personal property since he is the last one to own it as personal property.
>
> . . . .
>
> 4. Sales of materials to religious or charitable institutions and government agencies are exempt only if sold as tangible personal property and the seller does not install the material as an improvement to realty or use it to repair real property.

Utah Administrative Code R865-19-58S(A)(1) and (4). (Emphasis added.) The Commission concluded that since Arco installed the materials purchased by Granite, it was, therefore, the consumer of the materials so that a tax should be paid on the purchase of the materials.

Arco submits that Rule 42S is determinative of the issues in this case, but even if this case is reviewed solely in the context of Rule 58S, the Commission's conclusion places improper emphasis on the installation process to determine if a taxable event has occurred. In Rule 58S(A)(1), the term "consumer" is directly tied to the term "own." That is, in order for an entity to be a consumer of materials it must also be the owner of the materials. As applied to this case, Arco cannot be the consumer of the materials unless a determination is also made that Arco was also the owner of the materials.

The findings of fact and unrefuted evidence presented at the formal hearing show that Arco was not the owner of the materials. Arco did not purchase the materials. Arco did not pay for the materials. Arco did not insure the materials. Arco had no contractual relationship with the vendors of the materials. Vendors looked solely to Granite for payment of the materials. Arco had no responsibility to pay for the materials if Granite failed to do so. Title to the materials passed from the vendors directly to Granite without vesting in Arco. In short, the assessment was improperly made against Arco because Arco was not the purchaser or owner of the materials.

The recent Utah case of Tummurru Trades v. Utah State Tax Comm'n, 802 P.2d 715 (Utah 1990), offers additional insight

as to the ownership requirement of Rule 58S(1). In Tummurru Trades, the taxpayer purchased items to be used in construction projects located out of state. This Court stated:

> Because Tummurru took possession of the items within the State of Utah and title passed within the state, it became the ultimate consumer for sales tax purposes.

Id. at 719 (emphasis added). This Court then noted that Rule 58S(A)(1) "was promulgated to address this very issue." Id. at 719.

In essence, this Court has confirmed that in order for Arco to be a consumer of material for sales tax purposes under Rule 58S(1), it must also be the owner of the materials. If Arco had purchased the materials at issue and took title to them, Granite would not now be arguing that the governmental exemption is available. This matter is before this Court because Granite purchased the materials, paid for them, took title to them and used them in an essential governmental function.

Like Rule 58S(A)(1), Rule 58S(A)(4) does not support the Commission's decision. Rule 58S(A)(4) provides that sales to a government agency are exempt from sales tax if the supplier of the materials, i.e., the vendor from whom the materials are purchased, does not also install the materials. Utah Administrative Code R865-19-58S(4). In this case, none of the suppliers from whom Granite purchased materials also installed

the materials. Because the materials were sold to Granite and not installed by the vendors, the sale of the materials was sales tax exempt under Rule 58S(A)(4).

C. EVEN IF THERE IS CONFLICT OR AMBIGUITY REGARDING THE INTERPRETATION OF RULES 42(S) AND 58(S) ANY AMBIGUITY MUST BE RESOLVED IN FAVOR OF GRANITE.

General principles of statutory construction apply in interpreting agency rules and regulations. An agency interpretation of a statute or regulation that is contrary to the plain meaning of the language should not be deferred to on review. See e.g. Usury v. Kennecott Copper Corp., 577 F.2d 1113 (10th Cir. 1977); Carlyle Compressor Co. v. Occupational Safety & Health Review Commission, 683 F.2d 673 (2nd Cir. 1982). As noted in Carlyle, "[a]n agency does not have carte blanche to interpret its regulations to achieve a desired result." 683 F.2d at 673.

A fundamental principle in construing statutes is to determine the intent of the legislature. Johnson v. Tax Commission, 411 P.2d 831, 832 (Utah, 1966). Arco and Granite submit that legislative intent is clear. The governmental sales tax exemption is available in this case because Granite purchased and paid for the materials at issue. Granite believes that the statute, Rule 42(S) and Rule 58(S) all support an exemption.

However, even if the Court finds that some confusion, ambiguity or conflict exists in the statutes and rules in

applying the governmental sales tax exemption, the matter should still be resolved in favor of Arco and Granite. Utah courts have long held that the taxpayer is to be given the benefit of the doubt in construing tax statutes. In Pacific Intermountain Express Co. v. State Tax Comm'n, 329 P.2d 650, 651 (1958), the Court states: "We concede that taxing statutes are to be construed strictly and in favor of the taxpayer where doubtful."

This Court's practice is to "construe taxation statutes liberally in favor of the taxpayer, leaving it to the legislature to clarify an intent to be more restrictive if such intent exists." Salt Lake County v. Tax Commission, 779 P.2d 1131, 1132 (Utah 1989).

Thus, any conflict or confusion in applying the statute or rules to the facts of this case should be resolved in favor of Arco. If any change is to be made to the governmental sales tax exemption, it should be made by the legislature and not by selective interpretation by the Tax Commission.

D. THE DIRECT PURCHASE PROCEDURES USED BY GRANITE FOLLOW THIS COURT'S GUIDANCE ON HOW TO QUALIFY FOR THE GOVERNMENTAL EXEMPTION AND ARE CONSISTENT WITH THE PUBLIC POLICY PURPOSES OF THE GOVERNMENTAL EXEMPTION.

Several Utah cases have addressed issues related to those involved in this matter. These cases establish that purchases of materials made by a tax-exempt entity or its agent

for use in the construction of facilities for the tax-exempt entity are exempt from sales tax.

In the case of Utah Concrete Products Corp. v. State Tax Commission, 101 Utah 513, 125 P.2d 408 (1942), the contractor purchased materials from a supplier for use in a road construction project for the State of Utah and argued that no sales tax liability should arise because the construction project was for the benefit of the state, a tax-exempt entity. This Court found, however, that because the contractor purchased the materials, it was the consumer of the items and sales tax liability resulted. In reaching its conclusion, the Court emphasized the fact that the suppliers looked solely to the contractors for payment and not to the state. Id. at 125 P.2d 411. Significantly, however, no claim was made that the State of Utah had been the owner, purchaser or consumer of the materials. Moreover, the Court stated that had the state or its agent purchased the materials, no tax would have been incurred:

> It is true that under this section [predecessor to §59-12-104(2)] sales made directly by plaintiffs to the state would be exempted, but in the instant case the sales are to an independent contractor and not to an agent of the state.

Id.

In the subsequent case of Ford J. Twaits v. Utah State Tax Commission, 148 P.2d 343, 345 (1944), the contractor again argued that materials purchased by the contractor to be incorporated into a construction project for the U.S. Government should be sales tax exempt because the purchased materials were really for the benefit of the U.S. Government, a tax-exempt entity. The Court noted that the contractor paid for the materials and that title to materials did not pass to the government until the government paid for them through progress payments as the work was completed. Id. 148 P.2d at 344. Of particular significance to this case, the Court also noted the contract granted the government the right to issue tax exemption certificates to avoid the imposition of sales tax on materials purchased. No such certificates were issued, however, and the Court concluded the contractor was liable for sales or use tax on the materials purchased. The Court also stated,

> . . . it is apparent that the government did not intend in the instant case to exempt plaintiff [the contractor] from any local taxes. Had it so intended, it would have been a simple matter to authorize plaintiff to buy as an agent of the government, to issue a tax exemption referred to in Article 31 of the Contract, or otherwise declare the goods government property.

Id. 148 P.2d at 345.

In the case of Olson Construction Company v. State Tax Commission, 12 Utah 2d 42, 361 P.2d 1112 (1961), this Court again reiterated that the contractor was liable for sales tax on materials purchased by and paid for by the contractor for use in a federal government construction project.

In each of these three cases, the contractor purchased and paid for the materials. In this case, Granite, not Arco, purchased and paid for the materials. Granite is not aware of a prior Utah Court decision involving the availability of the governmental exemption where the materials at issue were purchased directly by the governmental entity.

Nevada, however, has decided such a case. In Nevada Tax Commission v. Harker and Harker, Inc., 699 P.2d 112 (1985), the contractor, Harker, acted as the agent of the City of Reno to procure materials for Reno to be used in the construction of a facility for the city. The Nevada Supreme Court determined that the contractor did not own the materials and rejected the Tax Commission's argument that the contractor was the consumer of the materials. The Nevada Court stated:

> . . . The Commission, however, cites to Ruling No. 67 which provides "a construction contractor is the consumer of all tangible personal property purchased for use in improving real property pursuant to a construction contract." The commission therefore concludes that since NRS 372.155 imposes a tax on the use, storage or other improving real property pursuant to a construction

> contract." The commission therefore concludes that since NRS 372.155 imposes a tax on the use, storage or other consumption of personalty, Harker necessarily must pay a use tax.
>
> Nevertheless, to apply Ruling No. 67 to the present case would counter Nevada's legislative intent to exempt its governmental entities from taxation (citations omitted). A contractor in Harker's position, were it to be the subject of such tax, would certainly include in its bid the amount of that tax. Thus the state by taxing a governmental contractor acting as a conduit for the government, would be collecting the same funds with the right hand that it would be paying out to the contractor with the left hand. To extend Ruling No. 67 to this situation would require the state to engage in a costly and circuitous exercise which would be unproductive and unconscionable. . . .
>
> We therefore conclude that Harker did not have sufficient incidence of ownership to warrant imposition of a use tax. Harker was acting as a mere conduit for the governmental entity thus any tax imposed upon Harker is necessary a tax imposed upon the governmental entity. The tax exempt entities are meant to remain as such and therefore Ruling No. 67 cannot be construed to apply in this situation. Id. at 114.

Granite is not aware of a Utah case that addresses this public policy in a sales tax setting similar to Harper. This Court, however, used essentially the same reasoning in the real property taxation case of Interwest Aviation v. County Board of Equalization, 743 P.2d 1222 (Utah 1987). The Court explained the basis for the governmental exemption as follows:

> Article XIII, §2 of the Utah Constitution and §59-2-1 exempt from taxation "property of" cities and other governmental bodies. The

> exemption is based on the policy that property owned by and used for the public benefit of one governmental entity or subdivision should not be taxed by another because that would defeat the purpose of the exemption. For one unit of government, for example, a city, to have to levy a tax so that it can pay taxes to another overlapping unit, for example, a county, makes little economic sense and is bad tax policy. In other words, county taxation of city-owned property would necessarily require additional taxation by the city of its taxpayers for the revenue to pay the county-imposed tax.

Id. at 1225.

Certainly the same public policy reasons apply in the sales tax arena. When a political subdivision, like Granite, is the purchaser, owner and true ultimate consumer of materials used in the construction of a school building, does it really make sense to collect sales tax from the political subdivision for the benefit of either the same or other political subdivisions? This is precisely the effect of the Tax Commission's holding in this case. The Commission undermines the very purpose for the governmental tax exemption and the legislative intent in granting the exemption.

E. GRANITE WAS THE LEGAL AND REAL OWNER OF THE MATERIALS PURCHASED BY GRANITE

In its decision the Tax Commission concluded that Arco bore the risks of ownership with respect to materials purchased

directly by Granite and that Granite "did not assume the burdens, risks, responsibilities and incidents of ownership" of such materials. Such bold conclusions are inconsistent with the governing documents, the unrefuted evidence presented at the hearing and the Tax Commission's own findings.

In the first place, it is true that Granite delegated to Broderick & Howell, the general contractor in this case (and not Arco), certain responsibilities with respect to the materials at issue, including responsibilities for storage, inspection and safe keeping of the materials once delivered to the job site. However, these responsibilities would frequently be found in an installation only contract and are typical of the obligations imposed on a bailee of materials in similar situations.

Further, when all of the evidence is looked at together (and not only just selected provisions of the Agreement), Granite and not Arco was the real owner and held the most significant "incidents of ownership" of the materials. Granite provided the specifications for the materials in the first place. Granite contractually reserved the right to purchase materials and alter the original Agreement. This right was exercised by Granite and with respect to Granite-purchased items, the Agreement was modified by change order to essentially an installation only contract. Granite, not Arco, submitted purchase orders to

suppliers. Granite, not Arco, purchased the materials. Granite, not Arco, paid for the materials. Suppliers looked solely to Granite and not Arco for payment of the materials. Arco had no liability to such suppliers if Granite failed to pay for the materials. Any responsibility assigned to Arco or Broderick & Howell with respect to risk of loss was eliminated by the fact that Granite, not Arco, insured the materials against such risks and paid the premiums on such insurance. As a specific example in this case, Granite's insurance company covered the loss of electrical materials stolen from the job site, which materials were to be installed by Arco. Warranties on the materials ran to Granite, not Arco. Granite, not Arco, was the ultimate consumer of the materials (i.e., the materials were incorporated into a school building maintained by Granite in the exercise of its essential governmental functions). Legal and real title to the materials passed from the suppliers to Granite without any vesting in Arco. Surplus materials belonged to Granite, not Arco. Granite had full-time employees and independently hired architects and contractors to inspect materials and supervise the installation process. Granite made the final decision as to which materials to purchase. Granite had the right to accept or reject suppliers of materials recommended by Arco or Broderick & Howell. Granite could do whatever it wanted with the materials

it purchased. If a problem developed with respect to materials purchased by Granite, Granite would, at its expense, attempt to identify the source of the problem such as defective material or unsatisfactory workmanship and then pursue the appropriate supplier or installer to rectify the problem. Arco concluded it had no liability with respect to defective materials purchased by Granite.

As set forth in the facts above, the contract documents and the evidence presented at the formal hearing demonstrated that Granite was the owner of the materials. The Commission attempts to avoid that conclusion by selective quotation of the contract documents. The actual conduct and practices of the parties clarified any gaps or ambiguities in the contract language and in some respects may have amended the contract language. Under Utah law the actions, understanding and conduct of the parties can be looked at to interpret contract language and to even modify contract language that otherwise appears clear on its face. See Eie v. St. Benedict's Hospital, 638 P.2d 1190 (Utah 1981); Bull Frog Marina v. Lentz, 28 Utah 2d 261, 501 P.2d 266 (1972); Bullough v. Sims, 16 Utah 2d 304, 400 P.2d 20 (1965). Thus, when the documents and evidence is looked at as a whole, the conclusion is that Granite, not Arco, was the owner of the materials.

The essence of Arco's involvement in this case was as an installer of materials purchased by Granite. It also shared with Broderick & Howell agency responsibilities in identifying suppliers of materials and receiving such materials prior to installation. The assumption by Arco of such agency and bailee responsibilities does not make Arco the owner of the materials.

When all of the facts and circumstances of the relationship between Arco and Granite are examined, including the actions and conduct of the parties, the preponderance of the benefits and burdens of ownership of the materials remained with Granite. Granite was both the purchaser and real owner of the subject materials. Under any interpretation of the relative Rules, Granite is entitled to the exemption.

F. THE TAX COMMISSION'S DECISION IN THE GRANITE PORTION OF THIS CASE IS INCONSISTENT WITH ITS PRIOR PRACTICES AND ITS DECISIONS IN PRIOR OR COMPANION EXEMPTION CASES.

As set forth in the facts, the direct purchase procedures used by Granite in this case were substantially the same as those used by other tax-exempt entities in similar fact situations. These procedures have been successfully used by Granite and other tax-exempt entities for numerous years. Beginning in approximately 1985, however, several contractors and subcontractors were audited and assessed sales tax by the Tax Commission with respect to materials purchased by tax-exempt

entities using the same basic direct purchase procedures as in this case. This assessment activity resulted in approximately 30 separate but similar cases before the Commission challenging the assessments. These cases involve several tax-exempt entities including political subdivisions such as Salt Lake County and school districts and several charitable organizations.

The first significant decision out of this collection of cases was decided by the Commission in the case of Horne Construction Corp. v. Audit Division of the State Tax Commission, Appeal No. 85-0118 (November 25, 1987), involving the direct purchase of construction materials by the Uintah County School District. A copy of the Horne decision is attached hereto as Addendum C. The facts in Horne are remarkably similar to the facts in this case, and the governing contract language is virtually identical. In Horne, the Commission ruled that the purchases were exempt based in significant part on the actions and conduct of the parties in the direct purchase arrangement.

One difference between the Horne case and this case is that Uintah County entered into contracts directly with subcontractors, whereas Granite had no direct contractual relationship with the subcontractors. Rather, the contractual relationship existed between the contractor, Broderick & Howell and the subcontractors, including Arco. That difference,

however, has no bearing on whether Granite or Arco purchased materials. Moreover, Granite and its employees and agents clearly had the right to control and in fact exercised substantial control and supervision over the construction of the two school buildings facilities, just as Uintah County's employees did in Horne.

After Horne the Commission sent a memorandum dated June 13, 1990 to petitioners in the approximate 30 cases pending before the Commission involving direct purchases by tax-exempt entities, a copy of which memorandum is attached hereto as Addendum D. In such memorandum, the Commission explained its position on the direct purchase procedures and outlined a four-part safe harbor to qualify for the exemption. The Commission's "minimum criteria" were:

> 1. The exempt organization must exercise direct supervision over the construction project.
>
> 2. Purchase orders must be issued by the exempt organization for all materials for which sales tax is not paid.
>
> 3. Payment must be made by the exempt organization for all materials for which sales tax is not paid.
>
> 4. Any furnish and install contracts entered into must have provisions in the contract for changes through change orders.

All four parts of the test announced in the memorandum are present in this case. Granite exercised direct supervision over the construction project, issued the purchase orders, and paid for the materials, and the Agreement specifically allowed for changes through change orders. The Commission's decision in this case is inconsistent with the four-part safe harbor test announced in the memorandum.

Another case recently decided by the Tax Commission was Layton Construction Co. v. The Auditing Division of the Utah State Tax Commission, Appeal No. 86-0650 (March 9, 1992), involving the direct purchase of materials by BYU. A copy of the decision in Layton is attached hereto as Addendum E. Again, the facts in Layton Construction are remarkably similar to the facts in this case, and the governing contract language is substantially the same. As in Horne, the Commission again found that the purchases by BYU were tax-exempt focusing on the actions and conduct of the parties with respect to the direct purchase procedures.

In denying the exemption to Granite in this case, the Commission lists only selected provisions of the Agreement as its basis for the denial while ignoring the conduct and actions of the parties and other unrefuted evidence presented at the formal hearing. Indeed, virtually every "negative" provision of the

Agreement cited by the Commission to support its decision in this case (Findings, pps. 33-34) was also present in the contract documents involved in both Horne and Layton. Such "negative" contract provisions were not listed as determinative factors in the Commission's June 13, 1990 memorandum.

Even in its decision involving Arco, the Tax Commission grants the exemption in favor of UTA but not for Granite or the LDS Church. As set forth in detail in the LDS Church's brief, the Tax Commission decision in this case cannot reasonably or fairly be explained with regard to the treatment of UTA vis-a-vis the other owners. Also as set forth in the LDS Church's brief the conclusions of law issued by the Commission are internally contradictory and inconsistent and offer confusing direction to taxpayers and tax exempt entities.

There is no fair or rational basis to the inconsistency in these decisions and pronouncements of the Commission. In fact, it appears that the Commission is trying to change old rules and create new ones to address these direct purchase programs. That is not the proper function of administrative hearing. If that is the Commission's desire, it must first amend the statute and change the clear legislative intent and then it must go through the proper rulemaking procedures.

CONCLUSION

Based upon the foregoing, Arco did not purchase, own or consume the subject materials and therefore the assessment of sales tax against it was improper. Granite was the true purchaser, owner and ultimate consumer of such materials. Because Granite is a tax-exempt entity, such purchases are exempt from Utah sales and use tax.

DATED this 6th day of August, 1992.

Thomas Christensen

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CERTIFICATE OF SERVICE

I hereby certify that on this 6th day of August, 1992, I caused to be mailed, first class, postage prepaid, a true and correct copy of the foregoing Brief of Appellant Arco Electric (With Respect to Granite School District Related Assessment), to:

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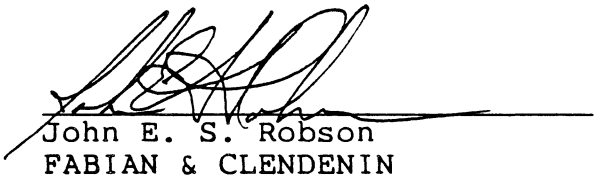

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ADDENDUM A

Constr. Co. v. State Tax Comm., 12 Utah 2d 53, 362 P.2d 422 (1961).

Purpose of use tax.

The obvious purpose of the former Use Tax Act was to impose a tax on the use in this state of property the sale of which, because that sale took place outside the state, was beyond the reach of the Utah Sales Tax Act. Union Portland Cement Co. v. State Tax Comm., 110 Utah 152, 176 P.2d 879 (1947).

Redress from assessment.

Procedure set forth in this chapter itself is the exclusive method of seeking redress from an assessment. Pacific Intermountain Express Co. v. State Tax Comm., 7 Utah 2d 15, 316 P.2d 549 (1957).

COLLATERAL REFERENCES

Am. Jur. 2d. — 69 Am. Jur. 2d Sales and Use Taxes §§ 1 to 243.

C.J.S. — 85 C.J S. State and Local Taxation §§ 1231 to 1257.

A.L.R. — Sales or use tax on motor vehicle purchased out of state, 45 A.L.R.3d 1270.

Applicability of sales tax to "tips" or service charges added in lieu of tips, 73 A.L.R.3d 1226.

Sales and use taxes on leased tangible personal property. 2 A.L.R.4th 859.

Freight, transportation, mailing, or handling charges billed separately to purchaser of goods subject to sales or use taxes, 2 A.L.R.4th 1124.

Cable television equipment or services as subject to sales or use tax, 5 A.L.R.4th 754.

Retailer's failure to pay to government sales or use tax funds as constituting larceny or embezzlement, 8 A.L.R.4th 1068.

Eyeglasses or other optical accessories as subject to sales or use tax, 14 A.L.R.4th 1370.

Use or privilege tax on sales of, or revenues from sales of, advertising space or services, 40 A.L.R.4th 1114.

Sales and use taxes on sale or lease of mailing or customer list, 80 A.L.R.4th 1126.

Key Numbers. — Taxation ⇐ 1201 to 1345.

59-12-102. Definitions.

As used in this chapter:

(1) "Commercial consumption" means the use connected with trade or commerce and includes:

(a) the use of services or products by retail establishments, hotels, motels, restaurants, warehouses, and other commercial establishments;

(b) transportation of property by land, water, or air;

(c) agricultural uses unless specifically exempted under this chapter; and

(d) real property contracting work.

(2) "Commission" means the State Tax Commission.

(3) "Component part" includes:

(a) poultry, dairy, and other livestock feed, and their components;

(b) baling ties and twine used in the baling of hay and straw;

(c) fuel used for providing temperature control of orchards and commercial greenhouses doing a majority of their business in wholesale sales, and for providing power for off-highway type farm machinery; and

(d) feed. seeds, and seedlings.

(4) (a) "Medicine" means:

(i) insulin, syringes, and any medicine prescribed for the treatment of human ailments by a person authorized to prescribe treatments and dispensed on prescription filled by a registered pharmacist, or supplied to patients by a physician, surgeon, or podiatrist;

(ii) any medicine dispensed to patients in a county or other licensed hospital if prescribed for that patient and dispensed by a

registered pharmacist or administered under the direction of a physician; and

(iii) any oxygen or stoma supplies prescribed by a physician or administered under the direction of a physician or paramedic.

(b) "Medicine" does not include:

(i) any auditory, prosthetic, ophthalmic, or ocular device or appliance; or

(ii) any alcoholic beverage.

(5) "Person" includes any individual, firm, partnership, joint venture, association, corporation, estate, trust, business trust, receiver, syndicate, this state, any county, city, municipality, district, or other local governmental entity of the state, or any group or combination acting as a unit.

(6) "Purchase price" means the amount paid or charged for tangible personal property or any other taxable item or service under Subsection 59-12-103(1), excluding only cash discounts taken or any excise tax imposed on the purchase price by the federal government.

(7) "Residential use" means the use in or around a home, apartment building, sleeping quarters, and similar facilities or accommodations.

(8) (a) "Retail sale" means any sale within the state of tangible personal property or any other taxable item or service under Subsection 59-12-103(1), other than resale of such property, item, or service by a retailer or wholesaler to a user or consumer.

(b) "Retail sale" includes sales by any farmer or other agricultural producer of poultry, eggs, or dairy products to consumers if the sales have an average monthly sales value of $125 or more.

(9) (a) "Retailer" means any person engaged in a regularly organized retail business in tangible personal property or any other taxable item or service under Subsection 59-12-103(1), and who is selling to the user or consumer and not for resale.

(b) "Retailer" includes commission merchants, auctioneers, and any person regularly engaged in the business of selling to users or consumers within the state.

(c) "Retailer" includes any person who engages in regular or systematic solicitation of a consumer market in this state by the distribution of catalogs, periodicals, advertising flyers, or other advertising, or by means of print, radio or television media, by mail, telegraphy, telephone, computer data base, cable, optic, microwave, or other communication system.

(d) "Retailer" does not include farmers, gardeners, stockmen, poultrymen, or other growers or agricultural producers producing and doing business on their own premises, except those who are regularly engaged in the business of buying or selling for a profit.

(e) For purposes of this chapter the commission may regard as retailers the following if they determine it is necessary for the efficient administration of this chapter: salesmen, representatives, peddlers, or canvassers as the agents of the dealers, distributors, supervisors, or employers under whom they operate or from whom they obtain the tangible personal property sold by them, irrespective of whether they are making sales on their own behalf or on behalf of these dealers, distributors, supervisors, or employers.

(10) "Sale" means any transfer of title, exchange, or barter, conditional or otherwise, in any manner, of tangible personal property or any other taxable item or service under Subsection 59-12-103(1), for a consideration. It includes:

(a) installment and credit sales;

(b) any closed transaction constituting a sale;

(c) any sale of electrical energy, gas, services, or entertainment taxable under this chapter;

(d) any transaction if the possession of property is transferred but the seller retains the title as security for the payment of the price; and

(e) any transaction under which right to possession, operation, or use of any article of tangible personal property is granted under a lease or contract and the transfer of possession would be taxable if an outright sale were made.

(11) "State" means the state of Utah, its departments, and agencies.

(12) "Storage" means any keeping or retention of tangible personal property or any other taxable item or service under Subsection 59-12-103(1), in this state for any purpose except sale in the regular course of business.

(13) (a) "Tangible personal property" means:

(i) all goods, wares, merchandise, produce, and commodities;

(ii) all tangible or corporeal things and substances which are dealt in or capable of being possessed or exchanged;

(iii) water in bottles, tanks, or other containers; and

(iv) all other physically existing articles or things, including property severed from real estate.

(b) "Tangible personal property" does not include:

(i) real estate or any interest or improvements in real estate;

(ii) bank accounts, stocks, bonds, mortgages, notes, and other evidence of debt;

(iii) insurance certificates or policies;

(iv) personal or governmental licenses;

(v) water in pipes, conduits, ditches, or reservoirs;

(vi) currency and coinage constituting legal tender of the United States or of a foreign nation; and

(vii) all gold, silver, or platinum ingots, bars, medallions, or decorative coins, not constituting legal tender of any nation, with a gold, silver, or platinum content of not less than 80%.

(14) (a) "Use" means the exercise of any right or power over tangible personal property under Subsection 59-12-103(1), incident to the ownership or the leasing of that property, item, or service.

(b) "Use" does not include the sale, display, demonstration, or trial of that property in the regular course of business and held for resale.

(15) "Vehicle" means any aircraft, as defined in Section 2-1-1; any vehicle, as defined in Section 41-1a-102; any off-highway vehicle, as defined in Section 41-22-2; and any vessel, as defined in Section 41-1a-102; that is required to be titled, registered, or both.

(16) "Vehicle dealer" means a person engaged in the business of buying, selling, or exchanging vehicles as defined in Subsection (15).

(17) "Vendor" means:

(a) any person receiving any payment or consideration upon a sale of tangible personal property or any other taxable item or service under Subsection 59-12-103(1), or to whom such payment or consideration is payable; and

(b) any person who engages in regular or systematic solicitation of a consumer market in this state by the distribution of catalogs, periodicals, advertising flyers, or other advertising, or by means of print, radio or television media, by mail, telegraphy, telephone, computer data base, cable, optic, microwave, or other communication system.

History: L. 1933, ch. 63, § 2; 1933 (2nd S.S.), ch. 20, § 1; 1935, ch. 91, § 1; 1937, ch. 110, § 1; 1939, ch. 103, § 1; C. 1943, 80-15-2; L. 1943, ch. 92, § 1; 1949, ch. 83, § 1; 1957, ch. 125, § 1; 1963, ch. 140, § 1; 1969, ch. 187, § 1; 1969 (1st S.S.), ch. 14, § 1; 1971, ch. 152, § 1; 1973, ch. 151, § 1; 1981, ch. 239, § 1; 1986, ch. 55, § 2; C. 1953, 59-15-2; renumbered by L. 1987, ch. 5, § 21; 1988, ch. 66, § 1; 1990, ch. 215, § 1; 1992, ch. 1, § 200.

Amendment Notes. — The 1988 amendment, effective July 1, 1988, added present Subsections (15) and (16) and redesignated former Subsection (15) as Subsection (17).

The 1990 amendment, effective July 1, 1990, subdivided Subsection (9), adding Subsection (c) and making stylistic changes, and in Subsection (17) added the subsection designation (a), added Subsection (b), and made related changes.

The 1992 amendment, effective January 30, 1992, in Subsection (15) substituted the code citations to § 41-1a-102 for "Section 41-1-1" and "Section 41-1-147" respectively, and made stylistic changes.

Legislative Intent. — Laws 1990, ch 215, § 3 provides: "The Legislature intends to make the changes in the definition and status of retailers and vendors under this act prospective only. It also intends that these changes may not be construed to require retailers, as defined in Subsection 59-12-102(9)(c), and vendors, as defined in Subsection 59-12-102(17)(b), to pay or collect and remit any sales or use tax that may have been otherwise due and payable before July 1, 1990."

Cross-References. — State Tax Commission, § 59-1-201 et seq.

NOTES TO DECISIONS

ANALYSIS

Construction.

This section and § 59-12-103 are correlative and complementary. Barrett Inv Co. v State Tax Comm., 15 Utah 2d 97, 387 P 2d 998 (1964); Ogden Union Ry & Depot v State Tax Comm., 16 Utah 2d 23, 395 P 2d 57 (1964)

Construction contracts.

Sales of products made by a manufacturer of building materials to contractors for use upon a private construction contract are taxable under the Emergency Revenue Act of 1933 (now this chapter) and subsequent amendments. Utah Concrete Prods. Corp. v State Tax Comm., 101 Utah 513, 125 P 2d 408 (1942).

Sales of personal property to a contractor constructing facilities for the federal government were not exempt from sales tax, even though the contracts involved provided for the vesting of title to all material in the federal government upon delivery to the job site and even though there was in existence at the time the contracts were executed a sales tax regulation of the commission which provided a sales tax exemption contrary to law Olson Constr Co. v State Tax Comm., 12 Utah 2d 42, 361 P 2d 1112 (1961)

Discharge of tax.

Tax may be discharged by payment to retailer from whom goods are purchased. Ford J.

deemed wholesale purchases and exempt from the sales tax. Barrett Inv. Co. v. State Tax Comm., 15 Utah 2d 97, 387 P.2d 998 (1964).

59-12-103. Sales and use tax base — Rate.

(1) There is levied a tax on the purchaser for the amount paid or charged for the following:

(a) retail sales of tangible personal property made within the state;

(b) amount paid to common carriers or to telephone or telegraph corporations, whether the corporations are municipally or privately owned, for:

(i) all transportation;

(ii) intrastate telephone service; or

(iii) telegraph service;

(c) gas, electricity, heat, coal, fuel oil, or other fuels sold or furnished for commercial consumption;

(d) gas, electricity, heat, coal, fuel oil, or other fuels sold or furnished for residential use;

(e) meals sold;

(f) admission to any place of amusement, entertainment, or recreation, including seats and tables reserved or otherwise, and other similar accommodations;

(g) services for repairs or renovations of tangible personal property or services to install tangible personal property in connection with other tangible personal property;

(h) cleaning or washing of tangible personal property;

(i) tourist home, hotel, motel, or trailer court accommodations and services for less than 30 consecutive days;

(j) laundry and dry cleaning services;

(k) leases and rentals of tangible personal property if the property situs is in this state, if the lessee took possession in this state, or if the property is stored, used, or otherwise consumed in this state; and

(l) tangible personal property stored, used, or consumed in this state.

(2) Except for Subsection (1)(d), the rates of the tax levied under Subsection (1) shall be:

(a) $5^{3}/_{32}\%$ through December 31, 1989; and

(b) 5% from and after January 1, 1990.

(3) The rates of the tax levied under Subsection (1)(d) shall be:

(a) $2^{3}/_{32}\%$ through December 31, 1989; and

(b) 2% from and after January 1, 1990.

(4) (a) From January 1, 1990, through December 31, 1999, there shall be deposited in an Olympics special revenue fund or funds as determined by the Division of Finance under Section 51-5-4, for the use of the Utah Sports Authority created under Title 9, Chapter 1, Part 3, Utah Sports Authority Act:

(i) the amount of sales and use tax generated by a $^{1}/_{64}\%$ tax rate on the taxable items and services under Subsection (1);

(ii) the amount of revenue generated by a $^{1}/_{64}\%$ tax rate under Section 59-12-204 on the taxable items and services under Subsection (1); and

(iii) interest earned on the amounts under Subsections (i) and (ii).

(b) These funds shall be used by the Utah Sports Authority as follows:

(i) to the extent funds are available, to transfer directly to a debt service fund or to otherwise reimburse to the state of Utah any amount expended on debt service or any other cost of any bonds issued by the state to construct any public sports facility as defined in Section 9-1-303; and

(ii) to pay for the actual and necessary operating, administrative, legal, and other expenses of the Utah Sports Authority, but not including protocol expenses for seeking and obtaining the right to host the Winter Olympic Games.

History: L. 1933, ch. 63, § 2; 1933 (2nd S.S.), ch. 20, § 1; 1935, ch. 91, § 1; 1937, ch. 110, § 1; 1939, ch. 103, § 1; C. 1943, 80-15-2; L. 1943, ch. 92, § 1; 1949, ch. 83, § 1; 1957, ch. 125, § 1; 1963, ch. 140, § 1; 1969, ch. 187, § 1; 1969 (1st S.S.), ch. 14, § 1; 1971, ch. 152, § 1; 1973, ch. 151, § 1; 1981, ch. 239, § 1; 1986, ch. 55, § 2; C. 1953, 59-15-2; renumbered by L. 1987, ch. 5, § 21; 1989, ch. 41, § 6; 1989 (2nd S.S.), ch. 5, § 5; 1990, ch. 22, § 1; 1990, ch. 171, § 1; 1991, ch. 152, § 1; 1992, ch. 241, § 370.

Amendment Notes. — The 1989 amendment, effective April 24, 1989, substituted "5 1/64%" for "5%" in Subsection (2)(b); substituted "2 1/64%" for "2%" in Subsection (3)(b); and added Subsection (4).

The 1989 (2nd S.S.) amendment, effective October 10, 1989, substituted "5%" for "5 1/64%" in Subsection (2)(b); substituted "2%" for "2 1/64%" in Subsection (3)(b); subdivided Subsection (4) and rewrote the introductory language of Subsection (4)(a), which read: "For fiscal year beginning July 1, 1990, there is appropriated to the entity created under Subsection 11-13-5.5(4)"; substituted "1/64%" for "1/32%" in two places in Subsection (4)(a)(i); and added Subsections (4)(a)(ii) and (4)(b)(i) and (ii).

The 1990 amendment by ch. 171, effective March 9, 1990, rewrote Subsection (4)(a)(i), which had read "the amount of sales and use tax generated by 1/64% of the tax levied under Subsection (2)(b) and 1/64% of the tax levied under Subsection (3)(b)" and Subsection (4)(a)(ii), which had read "the amount of revenue generated by 1/64% of the local option tax as provided in Subsection 59-12-205(4)," and inserted "administrative, legal" in Subsection (4)(b)(ii).

The 1990 amendment by ch. 22, effective July 1, 1990, subdivided Subsection (1)(b); deleted "as defined by Section 54-2-1" after "telegraph corporations" in paragraph of Subsection (1)(b); and added "intrastate" at the beginning of Subsection (1)(b)(ii).

The 1991 amendment, effective April 29, 1991, inserted "Utah Sports Authority Act" in Subsection (4)(a), and added Subsection (4)(a)(iii).

The 1992 amendment, effective March 13, 1992, substituted the reference to Title 9, Chapter 1, Part 3 for a reference to Title 62, Chapter 1 in Subsection (4)(a) and the reference to § 9-1-303 for a reference to § 62-1-102 in Subsection (4)(b)(1).

Cross-References. — County or municipal sales and use tax, provisions of ordinance, § 59-12-204.

NOTES TO DECISIONS

Analysis

Constitutionality.

Subsections (1)(c) and (1)(d) have been held to be constitutional against various contentions. State Tax Comm. v. City of Logan, 88 Utah 406, 54 P.2d 1197 (1936).

COLLATERAL REFERENCES

Am. Jur. 2d. — 68 Am. Jur. 2d Sales and Use Taxes §§ 128 to 138, 230, 231.

C.J.S. — 85 C.J.S. State and Local Taxation § 1245.

Key Numbers. — Taxation ⇐ 1231 et seq.

59-12-104. Exemptions.

The following sales and uses are exempt from the taxes imposed by this chapter:

(1) sales of motor fuels and special fuels subject to a Utah state excise tax under Title 59, Chapter 13, Motor and Special Fuel Tax Act;

(2) sales to the state, its institutions, and its political subdivisions;

(3) sales of food, beverage, and dairy products from vending machines in which the proceeds of each sale do not exceed $1 if the vendor or operator of the vending machine reports an amount equal to 120% of the cost of items as goods consumed;

(4) sales of food, beverage, dairy products, similar confections, and related services to commercial airline carriers for in-flight consumption;

(5) sales of parts and equipment installed in aircraft operated by common carriers in interstate or foreign commerce;

(6) sales of commercials, motion picture films, prerecorded audio program tapes or records, and prerecorded video tapes by a producer, distributor, or studio to a motion picture exhibitor, distributor, or commercial television or radio broadcaster;

(7) sales made through coin-operated laundry machines, coin-operated dry cleaning machines, or coin-operated car washes;

(8) sales made to or by religious or charitable institutions in the conduct of their regular religious or charitable functions and activities and, after July 1, 1993, if the requirements of Section 59-12-104.1 are fulfilled;

(9) sales of vehicles of a type required to be registered under the motor vehicle laws of this state which are made to bona fide nonresidents of this state and are not afterwards registered or used in this state except as necessary to transport them to the borders of this state;

(10) sales of medicine;

(11) sales or use of property, materials, or services used in the construction of or incorporated in pollution control facilities allowed by Sections 19-2-123 through 19-2-127;

(12) sales or use of property which the state is prohibited from taxing under the Constitution or laws of the United States or under the laws of this state;

(13) sales of meals served by:

(a) public elementary and secondary schools;

(b) churches, charitable institutions, and institutions of higher education, if the meals are not available to the general public; and

(c) inpatient meals provided at medical or nursing facilities;

(14) isolated or occasional sales by persons not regularly engaged in business, except the sale of vehicles or vessels required to be titled or registered under the laws of this state;

(15) sales or leases of machinery and equipment purchased or leased by a manufacturer for use in new or expanding operations (excluding normal operating replacements, which includes replacement machinery and

equipment even though they may increase plant production or capacity, as determined by the commission) in any manufacturing facility in Utah. Manufacturing facility means an establishment described in SIC Codes 2000 to 3999 of the 1987 Standard Industrial Classification Manual, of the federal Executive Office of the President, Office of Management and Budget. For purposes of this subsection, the commission shall by rule define "new or expanding operations" and "establishment." By October 1, 1991, and every five years thereafter, the commission shall review this exemption and make recommendations to the Revenue and Taxation Interim Committee concerning whether the exemption should be continued, modified, or repealed. In its report to the Revenue and Taxation Interim Committee, the tax commission review shall include at least:

(a) the cost of the exemption;

(b) the purpose and effectiveness of the exemption; and

(c) the benefits of the exemption to the state;

(16) sales of tooling, special tooling, support equipment, and special test equipment used or consumed exclusively in the performance of any aerospace or electronics industry contract with the United States government or any subcontract under that contract, but only if, under the terms of that contract or subcontract, title to the tooling and equipment is vested in the United States government as evidenced by a government identification tag placed on the tooling and equipment or by listing on a government-approved property record if a tag is impractical;

(17) intrastate movements of freight and express or street railway fares;

(18) sales of newspapers or newspaper subscriptions;

(19) tangible personal property, other than money, traded in as full or part payment of the purchase price, except that for purposes of calculating sales or use tax upon vehicles not sold by a vehicle dealer, trade-ins are limited to other vehicles only, and the tax is based upon the then existing fair market value of the vehicle being sold and the vehicle being traded in, as determined by the commission;

(20) sprays and insecticides used to control insects, diseases, and weeds for commercial production of fruits, vegetables, feeds, seeds, and animal products;

(21) sales of tangible personal property used or consumed primarily and directly in farming operations, including sales of irrigation equipment and supplies used for agricultural production purposes, whether or not they become part of real estate and whether or not installed by farmer, contractor, or subcontractor, but not sales of:

(a) machinery, equipment, materials, and supplies used in a manner that is incidental to farming, such as hand tools with a unit purchase price not in excess of $100, and maintenance and janitorial equipment and supplies;

(b) tangible personal property used in any activities other than farming, such as office equipment and supplies, equipment and supplies used in sales or distribution of farm products, in research, or in transportation; or

(c) any vehicle required to be registered by the laws of this state, without regard to the use to which the vehicle is put;

BEFORE THE STATE TAX COMMISSION OF UTAH

HORNE CONSTRUCTION CORP., Petitioner,	:)	
v.	:)	FINDINGS OF FACT, CONCLUSIONS OF LAW AND FINAL DECISION
AUDIT DIVISION OF THE STATE TAX COMMISSION OF UTAH, Respondent.	:) :) :)	Appeal No. 85 0118

STATEMENT OF CASE

This matter came before the Utah State Commission for a Formal Hearing on May 27, 1987. The entire tax Commission was present with Roger O. Tew conducting the proceedings. Mary Beth Walz, Assistant Attorney General, appeared on behalf of the Respondent. Gayle McKeachnie and Clark Allred appeared representing the Petitioner and Uintah School District.

After reviewing the evidence and arguments presented at the Formal Hearing the Tax Commission makes its

FINDINGS OF FACT

1. Uintah County School District entered into two major construction projects in 1984-1985. One of these projects involved remodeling and constructing medicinal

facilities on the West Junior High School. The other project involved the construction of the new Uintah High School together with the adjoining parking lot of the athletic fields.

2. The Uintah School District undertook the responsibilities of the construction project itself. Rather than hire a prime contractor the school district acted as the prime contractor for both projects. To act as prime contractor the school district hired Dirk Harris to oversee the project.

3. Mr. Harris was hired and given an office in the school district's offices. He was designated to represent the school district in performing its duties as the prime contractor. The school district then entered into twenty-two separate contracts with various businesses for the construction of the Uintah High School and eight businesses for the work to be performed at the West Junior High School.

3. The contracts included site preparation, mechanical, electrical, general construction, educational equipment, carpet, lockers, bleachers, library shelving, shop equipment, auditorium seating, state equipment, state lighting, gym flooring, athletic track, fencing, sprinkling system, Toro equipment, tennis courts, and stadium seating.

4. One of the twenty-two contracts was let to Horne Construction Company. Horne Construction Company was to provide general construction on the main building and a few other items.

5. As part of the contract, the school district reserved the rights in all of its contracts to purchase the materials to be used in the construction of the two facilities. That provision provided "The owners (school district) shall have the right to furnish any part or all of the materials and equipment which shall become a part of the permanent structure."

6. If the school district elected to furnish the materials it would issue a purchase order to the vendor, the vendor would then deliver the materials to the job site. Upon delivery to the job site title to the materials would pass directly from the vendor to the school district. The school district had the responsibility of paying for the materials.

7. The school district exercised its option on all of its contracts on the two projects to purchase and furnish materials.

8. The school district secured lists and specifications through Dirk Harris from the various contractors. The school district then issued change orders to the various contractors deleting the need to supply the materials and the cost of the materials from the contract. The school district then issued a purchase order directly to the vendor for the materials.

9. The contracts with the various subcontractors then became labor only contracts. The vendor supplied all materials to the construction site and title passed directly to the school district. Vendor then built a school district for the

materials which paid for the materials by check issued directly from the school district.

10. All vendors billed and receive payment from the school district and did not look for payment from the contractors.

11. All warranties on the materials run to the school district and the school district was and is responsible for enforcing any and all warranties.

12. School district provided insurance coverage for the materials after purchase and through construction of the building.

13. School district was the owner of all surplus materials.

14. School district inspected the materials when they arrived on the job site and then at times refused delivery of defective materials.

Based upon the foregoing Findings of Facts, the Commission enter its

CONCLUSIONS OF LAW

1. Petitioner did not purchase the materials used in the construction of the Uintah High School and therefore it is not liable for the payment of sales tax on those materials.

2. Purchase of materials by the Uintah School District are exempt from sales tax pursuant to Utah Code Ann. §59-15-6(1986)

3. The materials used by the Petitioner in the construction of the Uintah High School were purchased and owned by the Uintah School District are exempt from sales tax.

FINAL DECISION

Therefore it is hereby decided that the sales tax assessment against the Petitioner, Horne Construction Corporation, for the period of January 1, 1984 through April 30, 1985 and the accompanying penalties and interest be rescinded.

DATED this 25th day of November, 1987.

BY ORDER OF THE STATE TAX COMMISSION OF UTAH.

R.H. Hansen
Chairman

Roger O. Tew
Commissioner

Joe B. Pacheco
Commissioner

G. Blaine Davis
Commissioner

NOTICE: It is hereby given that you have 30 days from the date of mailing of this decision to appeal to the Tax Court or the Supreme Court of the State of Utah.

JEH/hmm/4817w

ADDENDUM B

BEFORE THE UTAH STATE TAX COMMISSION

ARCO ELECTRIC, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	)	FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION Appeal No. 87-1276

STATEMENT OF CASE

This matter came before the Utah State Tax Commission for a formal hearing on August 27, 28 and 29, 1991. G. Blaine Davis, Administrative Law Judge, Presiding Officer, heard the matter for and on behalf of the Commission. Joe B. Pacheco, Commissioner was present and heard the case on August 27, and 28, 1991. S. Blaine Willes, Commissioner, was present and heard the case on August 28 and 29, 1991. Present and representing the Petitioner was Dudley Amoss, Attorney at Law. Present and representing Utah Transit Authority were Gayle F. McKeachnie, Attorney at Law, of the firm McKeachnie and Allred, and William D. Oswald, Attorney at Law. Present and representing the Granite School District was Thomas Christensen, Jr., Attorney at Law, of the firm Fabian and Clendenin. Present and representing the Church of Jesus Christ of Latter Day Saints were Graham Dodd and Robert P. Lunt, Attorneys at Law, of the firm Kirton, McConkie and Poelman.

Present and representing the Respondent was Clark Snelson, Assistant Utah Attorney General.

This proceeding involves an audit which was performed by Respondent upon Petitioner for the years in question. The audit involved construction projects for three separate entities. Those projects were the Utah Transit Authority's facilities at its Northern Division at 135 West 17th Street, Ogden, Utah; Granite School District's Westbrook Elementary School at 6200 South 3500 West, Salt Lake City, Utah, and Valley Crest Elementary School at 3100 South 5300 West, Salt Lake City, Utah; and the Printing Center for the Church of Jesus Christ of Latter Day Saints at 1980 West Industrial Circle, Salt Lake City, Utah.

All of the construction projects were handled on different contracts, and were therefore legally distinguishable. The projects for each owner or exempt entity were therefore heard as separate proceedings on three different days. However, because there was just one single audit performed on Petitioner, and because the audit was appealed as a single case number, all of those matters will be decided herein.

Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

Facts Regarding Utah Transit Authority

1. The tax in question is sales and use tax.

2. The period in question is January 1, 1982 to March 31, 1987.

3. The Utah Transit Authority is a political subdivision of the State of Utah, created under the Utah Public Transit District Act found at Utah Code Sec. 17A-2-1001 et. seq.

4. The Utah Transit Authority entered into a contract directly with ARCO Electric on September 27, 1985.

5. The contract between Utah Transit Authority and ARCO Electric contained a provision which required ARCO Electric to "furnish labor, supervision, equipment, supplies and materials" in connection with the construction of the Utah Transit Authority's facilities at its Northern Division.

6. The low bid for materials and labor was $707,156.00. It was broken down as $427,400.00 for materials and $279,756.00 for labor. The original contract between the Utah Transit Authority and ARCO was $279,756.00.

7. Because of changes to the original contract, the final payment to ARCO Electric was $294,762.78. These changes were to reflect additional work required of ARCO.

8. The Utah Transit Authority hired Jacobsen Construction as the Construction manager at the site, with Kevin Brown, an employee of Jacobsen Construction, as its on-site Project Manager at the Ogden facility where ARCO performed the work covered by the contract.

9. Paragraph 5 on page 3 of the Construction Management contract between the Utah Transit Authority and Jacobsen Construction required that;

> "All tangible personal property used in the construction of the Northern Division Facility will be purchased by CM acting as agent of Owner ...."

10. Procurement of materials for the Ogden facility was initiated by the issuance of Utah Transit Authority purchase orders by Jacobsen Construction's project manager, Kevin Brown.

11. Precontract bids obtained through public bidding determined where materials for the project would be obtained.

12. Approximately twenty (20) open purchase orders were issued by Utah Transit Authority to individual vendors for the materials needed at the facility.

13. The Utah Transit Authority arranged with each vendor to purchase the goods, to have the goods delivered to Utah Transit Authority property, and used a Utah Transit Authority check to pay for the goods referencing the assigned purchase order number.

14. Vendors then set up a customer file on the Utah Transit Authority Ogden facility, using one or more open purchase orders for all subsequent purchases.

15. The terms of the purchase orders issued by the Utah Transit Authority to each vendor required the Utah Transit Authority to pay for materials and any freight charges either as part of the purchase price or as a separate item.

16. The purchase order included the following language:

> UTAH SALES TAX DOES NOT APPLY
>
> Utah Transit Authority is exempt from all State Sales and use taxes under Sec. 11-20-55 of the laws of Utah and from Federal excise taxes under exemption No. 87-70-0023-K.

17. The contract between ARCO and the Utah Transit Authority contains language as follows:

> 6.1 Sales and Use Tax: Contractor acknowledges that Authority is a public entity exempt from the payment of all Utah sales and use taxes and covenants and agrees that it will cooperate with Authority in helping Authority to legally avoid the Utah sales and use taxes on the project.

18. The open purchase orders were very non-specific and did not specify the individual items of materials to be provided. When those items were billed, especially the items billed by General Electric Supply Company the invoices were billed to ARCO Electric and not to the Utah Transit Authority. Frequently the purchase orders were not issued until after the materials and invoices had already been received, and then Petitioner would send a letter to Jacobsen Construction (not the Utah Transit Authority) requesting that Jacobsen Construction issue a purchase order. The substance was that Jacobsen Construction was creating the paper trail for the Utah Transit Authority. (See Exhibits M, N, O, P and Q).

19. The Utah Transit Authority purchased insurance to cover any loss due to fire or other loss or damage to materials purchased by the Utah Transit Authority.

20. When damages occurred to property purchased by Utah Transit Authority on the project the Utah Transit Authority notified its insurance carrier of the claim, and obtained replacement materials from the suppliers.

21. ARCO Electric did not issue any purchase order for materials or make payment for materials included in the audit.

22. Materials ordered under Utah Transit Authority purchase orders were delivered to the Ogden Utah Transit Authority site in Ogden, Utah, unless otherwise specified.

23. Since 1979, the Utah Transit Authority has had on going communications with the staff of the Utah State Tax Commission, Auditing Division, with reference to its purchases of material for real property construction qualifying for the tax exempt status.

24. On August 15, 1979, William D. Oswald, Legal Counsel for the Utah Transit Authority, met with Donald R. Bosch, Assistant Chief Auditor Utah State Tax Commission, and Joe Zvonek, his assistant, to review procedures which the Utah Transit Authority intended to follow.

25. At that meeting, Mr. Bosch and Mr. Zvonek outlined for Mr. Oswald the Tax Commission's requirements for purchasing the materials for Utah Transit Authority projects to ensure that the purchases were tax exempt.

26. Later, a question arose on the procedures being used by the Utah Transit Authority on a contract with Allen Steel Company. Mr. Oswald met again with Don R. Bosch on February 2, 1982 to review the procedures.

27. Mr. Oswald confirmed his understanding of what was said at the February 2, 1982 meeting with a letter dated February 9, 1982. Mr. Bosch did not respond to that letter and did not communicate or in any way indicate to Mr. Oswald that

his understanding as stated in the letter was not correct.

Facts Regarding Granite School District

1. The tax in question is sales and use tax.

2. The period in question is January 1, 1982 to March 31, 1987.

3. Granite School District is a political subdivision of the State of Utah.

4. Westbrook Elementary School and Valley Crest Elementary School were constructed pursuant to an agreement between the Granite Board of Education (owner) and Broderick & Howell Construction Company (the contractor) dated July 18, 1984 (the "Agreement").

5. The contractor was selected by Granite as the general contractor after submission of bids by Broderick & Howell and other contractors for the construction of the two school buildings.

6. The right of the owner to furnish materials and equipment used in the construction of the two school buildings is set forth in the Supplementary General Conditions which were made available to all general contractor and subcontractor bidders on the project prior to the actual bidding process, which provided, substantially as follows:

a. The bid price submitted by the contractor included all labor, plant, materials, equipment, transportation, services and any other items required for construction and completion of the project.

b. It was mandatory for the contractor and subcontractors to allow the owner to purchase directly

from suppliers any part or all of the materials and equipment which would become a part of the permanent structure.

c. The contractor would negotiate, and administer all direct purchases by the owner and furnish to the owner a description, source of supply and other information necessary to enable the owner to purchase directly the materials and equipment.

d. Purchases by the owner were to be made on requisition or purchase orders furnished by the owner and signed by the duly authorized purchasing agent of the owner.

e. Title to all materials and equipment purchased by the owner was to pass from the vendor directly to the owner upon delivery to the job site without any vesting in the contractor.

f. After delivery, the risk of loss, damage, theft, vandalism, or destruction of or to such materials and equipment purchased directly by the owner were to lie with the contractor.

g. Storage of any materials and equipment furnished by the owner were to be the responsibility of the contractor.

h. The contractor was required to hold the owner harmless of and from any failure of the materials or equipment purchased by the owner which resulted in any loss, claim, defect, discrepancy, delay in delivery or any problem relating to the materials or equipment.

i. The contractor was required to acknowledge receipt and approval of any materials or equipment purchased directly by the owner by signing the invoice for those materials or equipment.

j. The owner was required to make payment for those materials and equipment within a reasonable time after the receipt of the signed invoice from the contractor.

k. The owner was not responsible for the loss of any prompt payment discount from the purchase price if the owner made payment within ten business days following the receipt of the signed invoice from the contractor.

l. The contract price was reduced by the amount actually paid by the owner for the materials and equipment purchased directly by the owner and by the sales tax which would have been paid on such materials and equipment had they been supplied by the contractor. Similarly, the amount of any progress payment was adjusted to reflect the direct purchase of any materials and equipment by the owner.

m. The owner was not responsible for the loss or reduction of any trade discounts. Such loss or reduction of trade discounts would be charged to the contractor.

n. All bonds and insurance called for in the Construction Agreement remained in full force. There was no reduction in the amount of coverage or any deduction for premiums for those bonds and insurance.

o. The provisions for direct purchase by the owner of

materials and equipment did not relieve the contractor of any of its duties or obligations under the contract or constitute a waiver of any of the owner's rights.

7. Arco Electric, the Petitioner in this matter was a subcontractor of Broderick & Howell Construction Company and performed electrical subcontract work pursuant to two separate Subcontract Agreements with Broderick & Howell, one for Westbrook Elementary and the second for Valley Crest Elementary, both dated August 6, 1984. Both Subcontract Agreements are identical.

8. The General and Supplementary Conditions between Granite and Broderick and Howell were incorporated into the subcontract agreements between Petitioner and Broderick and Howell by reference.

9. The subcontract agreements granted to the owner the right to furnish any part or all of the materials and equipment which would become part of the permanent structure of the school buildings.

10. Pursuant to those provisions, the owner elected to furnish certain electrical materials and equipment incorporated into the elementary school building facilities by Petitioner pursuant to its agreement with Broderick & Howell.

11. Materials and equipment incorporated into the elementary school facilities which were not furnished by the owner were furnished by Petitioner or Broderick & Howell and sales tax was paid on those materials.

12. With respect to materials and equipment elected to be furnished by the owner, Broderick & Howell would prepare

and deliver to the owner a requisition form identifying materials and equipment and the suppliers of the materials and equipment.

13. When the requisition form was received by the owner, a purchase order was then issued by the owner to the approved supplier of the materials and equipment identified in the requisition form.

14. When the materials and equipment were delivered to the job site address, the supplier sent an invoice for the materials and equipment to the owner in care of the contractor for approval and payment.

15. The authorized agent of the contractor would acknowledge receipt and approval of the materials and equipment identified in the invoice by signing the invoice and then forwarding it to the owner for payment.

16. Once approved for payment, the invoice would then be paid by the owner to the supplier by check drawn on the operating account of the owner by the disbursing agent of the owner.

17. After the owner had made payment for the materials and equipment, a change order to the original agreement with the contractor would then be executed giving the owner credit under the agreement for the cost of the materials and equipment plus the sales tax savings associated with the materials and equipment.

18. M.H.T. Architects, Inc. ("M.H.T."), was employed by the owner to provide various professional services with

respect to the construction of the two elementary school facilities, including the observation of installation and construction efforts, testing of material and approval of change orders.

19. M.H.T. had no contractual relationship with the contractor or Petitioner.

20. At all times during the installation and construction process the owner maintained a general liability insurance policy covering among other things, theft, vandalism and casualty losses from materials and equipment purchased by the owner and used in the construction of the elementary school facilities.

21. the owner also maintained a fire and extended coverage insurance policy in the amount of the insurable value of the facilities.

22. Lien waivers were secured by the contractor with respect to materials and equipment furnished by Petitioner or the contractor.

23. Lien waivers were not secured by the contractor or Petitioner with respect to materials and equipment furnished by the owner. The owner's cancelled checks were accepted in place of lien waivers.

24. Any excess materials were the property of the owner.

Facts Regarding Church of Jesus Christ of Latter Day Saints Print Center

1. The tax in question is sales and use tax.

2. The period in question is January 1, 1982 to March 31, 1987.

3. In 1986, The Church of Jesus Christ of Latter-day Saints (The "Church" or "Owner") entered into a contract with Interwest Construction Company ("Interwest") to construct a printing center (the "Print Center").

4. As part of the construction of the Print Center, Interwest subcontracted with the Petitioner, ARCO Electric ("ARCO") to work on the electrical system required by the Print Center.

5. Under its subcontract, ARCO was subject to the same general terms and conditions as the general contractor, Interwest.

6. The general requirements of the contract with Interwest required the Petitioner to provide at its expense all materials, labor, equipment, tools, transportation and utilities, including the costs of connection necessary for the successful completion of the project.

7. The contract also contemplated that some of the Print Center materials to be installed would be furnished by the owner.

8. The contract required the Petitioner to install certain items furnished by the owner, and to receive and store in safe condition certain other items which were to be purchased directly by the owner.

9. The contract provided for direct purchase of a waste collection system which would be delivered by the owner f.o.b. job site. Pursuant to the contract the Petitioner was to receive the equipment and be responsible for its protection

and proper installation. After receipt of the equipment, the contractor's responsibilities were the same as if they had negotiated the purchase.

10. The Church reserved the right in the contract to purchase materials to be used in the construction of the Print Center. Those purchases were handled as follows:

a. The owner and the Petitioner would mutually agree which materials were to be purchased by the Owner.

b. The cost of those materials, together with the amount the Petitioner would have paid as sales tax, were to be deducted from the contract sum as specified by change order, unless the materials were specifically deleted from the contract.

c. Upon agreement between the owner and the Petitioner regarding the materials the owner was to purchase, the contractor would furnish the owner the necessary information, including source of supply, to enable the owner to purchase the materials.

d. The Petitioner was required to hold the owner harmless of and from any failure of the supplies or materials so purchased resulting in any loss, claim, defect, discrepancy, delay in delivery, or any other problem relating to the materials, except where any failure was directly caused by acts or omissions of the owner.

e. All bonds and insurance called for in the contract were required to remain in full force. There was to be no reduction in the amount of coverage or any deduction for premiums for said bonds and insurance.

f. Materials ordered by the owner were not to be paid for until written approval was given by the contractor.

g. These conditions which applied to owner provided materials did not abrogate the Petitioner's responsibility to comply fully in the execution of the work as required by the contract documents.

h. The Petitioner was required to receive all merchandise, inspect it, and be fully responsible to see that it met the specifications, and assure that its storage and installation gave the owner a completed product according to the intention of the contract.

11. "Change Orders," were permitted by the contract.

12. The Church employed Robert Haywood as its "Project Representative." (That term is defined in the General Conditions as: "That individual designated by the . . . owner as it's full time representative on the project during construction."

13. The project representative was a full-time Church employee whose duties included insuring that the Print Center

materials in the possession of ARCO were handled in accordance with the contract.

14. The contract required the Petitioner to receive and store any materials purchased under the owner purchase option. This obligation included providing sheds for the storage of any material subject to weather damage and securing the work and materials each night.

15. The Church exercised its option to furnish Print Center materials in connection with the work of ARCO electric.

16. The Church, through its project representative, secured material lists from ARCO and consulted with ARCO and Interwest regarding the materials ARCO needed to perform its work.

17. A purchase order was then prepared by ARCO which was reviewed and approved by ARCO, Interwest, the project representative and Church Purchasing for accuracy and compliance with the contract terms. Thereafter, if everything was found to be proper, a purchase order was issued directly by the Purchasing Department of the Church to the appropriate vendor.

18. With one exception, the vendors were instructed to send the Print Center materials to the Print Center. The Petitioner, and not the Church, had the responsibility to receive and inspect these materials. The Print Center materials were also inspected by the Church's project representative.

19. In accordance with the instructions on the Church

purchase orders, the vendors billed the Church directly for the Print Center materials.

20. The invoices were received and checked by the Church, then forwarded to ARCO, which verified the appropriateness of payment and then re-forwarded the invoices to Interwest for its verification and approval.

21. Upon receiving the vendor's bill back from Interwest, with verification from the project representative that the Print Center materials appeared to be in conformance with the contract and purchase order, and written approval from the contractor, the Church made payment for the Print Center materials directly to the vendor.

22. Title to the Print Center materials passed directly from the vendor to the Church.

23. The vendors looked to the Church, not to ARCO or Interwest for payment.

24. Change orders were issued crediting the owner for payments made to suppliers.

25. Under this procedure suppliers were paid timely. The standard 10% contract retainage was not withheld on materials purchased by the Church.

26. All warranties on the Print Center materials were obtained by the Petitioner in favor of the owner.

27. The contract required the Church to provide a Builders Risk Policy insuring both ARCO and the Church which contained provisions to:

> a. Insure against all risk of direct physical loss of, or damage to, the property covered from any external cause.

b. All claims for loss or expense arising out of any one occurrence were to be adjusted as one claim, and from the amount of such adjusted claim, there was to be deducted the sum of $350.00 from loss resulting from the perils of fire, lightning, extended coverages and vandalism, and malicious mischief. There was also deducted the sum of $1,000.00 from any other covered peril. (The deductible amounts were the responsibility of the Contractor or subcontractor.)

CONCLUSIONS OF LAW

1. Sales made to the state, its institutions, and its political subdivisions are exempt from sales and use taxes. (Utah Code Ann. §59-12-104(2).)

2. Sales made to or by religious or charitable institutions in the conduct of their regular religious or charitable functions and activities are exempt from sales and use taxes. (Utah Code Ann. §59-12-104(8).)

3. Sales of tangible personal property to real property contractors and repairmen of real property are subject to sales and use taxes. (Rule R865-19-58S).

4. The person who converts personal property into real property is the consumer of the personal property since he or she is the last person to own it as personal property. (Rule R865-19-58S). Utah Concrete Products Corp. v. State Tax Commission, 802 P.2d 408 (Utah 1942); Olson Construction Company v. State Tax Commission, 12 Utah 2d 42, 361 P.2d 1112 (Utah 1961); and Tummurru Trades, Inc. v. Utah State Tax Commission, 802 P.2d 715 (Utah 1990).

5. The contractor or repairman is the consumer of tangible personal property used to improve, alter or repair real property. (Rule R865-19-58S).

6. Sales of materials and supplies to contractors and subcontractors are taxable transactions as sales to final consumers, even if the contract is performed for a religious institution, charitable organization, or governmental instrumentality. (Rule R865-19-58S).

7. Sales of materials to religious institutions, charitable organizations, and governmental instrumentalities are exempt only if sold as tangible personal property and the direct or indirect seller does not install the material as an improvement to realty or use it to repair real property. (Rule R865-19-58S).

8. The contractor must accrue and report tax on all merchandise bought tax-free and used in performing contracts to improve or repair real property. (Rule R865-19-58S).

9. Rule R865-19-58S is the primary rule governing the sale of materials and supplies sold to owners, contractors and repairmen of real property, and it sets forth the requirements for the taxation of the sale or acquisition of tangible personal property which is to be used to improve, alter or repair real property. That rule provides in relevant part:

> **A.** Sale of tangible personal property to real property contractors and repairmen of real property is generally subject to tax.
>
> 1. The person who converts the personal property into real property is the consumer of the personal property since he is the last one to own it as personal property.

> 2. The contractor or repairman is the consumer of tangible personal property used to improve, alter or repair real property; regardless of the type of contract entered into--whether it is a lump sum, time and material, or a cost-plus contract.
>
> 3. The sale of real property is not subject to the tax nor is the labor performed on real property. For example, the sale of a completed home or building is not subject to the tax, but sales of materials and supplies to contractors and subcontractors are taxable transactions as sales to final consumers. This is true whether the contract is performed for an individual, a religious institution, or a governmental instrumentality.
>
> 4. Sales of materials to religious or charitable institutions and government agencies are exempt only if sold as tangible personal property and the seller does not install the material as an improvement to realty or use it to repair real property.

Petitioner has brought Rule R865-19-42S to the attention of the Commission, which rule provides:

> A. Sales made to the state of Utah, its departments and institutions or to its political subdivision such as counties, municipalities, school districts, drainage districts, irrigation districts, and metropolitan water districts are exempt from tax if such property [sic] for use in the exercise of an essential governmental function. <u>If the sale is paid for by a warrant drawn upon the state treasurer or the official disbursing agent of any political subdivision, the sale is considered as being made to the state of Utah or its political subdivisions and exempt from tax.</u>

10. Sales of materials from a vendor to a contractor or other person or entity for use in the construction, improvement, alteration or repair of real property for a governmental entity, religious institution or charitable

organization is not exempt from sales and use tax. The incidents of the tax have been imposed on the contractor and not on the exempt entity. To be exempt, the sale must be from the vendor directly to the governmental entity, religious institution or charitable organization for the use of, and consumption by, the exempt entity.

11. The fact that the burden of the tax may be passed by the contractor on to the exempt entity in the form of higher prices and is thus paid indirectly by the exempt entity does not result in tax exemption for the transaction. (Rule R865-19-58S), Utah Concrete Products Corp. v. State Tax Commission, 101 Utah 513, 125 P.2d 408 (1942), and Ford J. Twaits Co. v. Utah State Tax Commission, 106 Utah 343, 148 P.2d 343 (1944), Olsen Construction Company v. State Tax Commission, 12 U.2d 42, 361 P.2d 1112 (1961).

12. Parties seeking exemptions from the imposition of that tax bear the burden of proving that they qualify and are legally entitled to the exemption. Parson Asphalt Products v. Utah State Tax Commission, 617 P.2d 397 (1980).

13. In order for the sale to the exempt entity to be exempt from sales and use tax it must be a bona fide sale to the exempt entity acting either in the capacity as the final consumer of tangible personal property or the entity which converts the tangible personal property to real property. The sale is such a bona fide sale to an exempt entity only if either:

a. The sale of materials or supplies is to the exempt entity and the exempt entity has its own

employees attach the materials and/or supplies to the realty, or

b. The sale of materials and supplies is to the exempt entity, and the exempt entity separately hires a contractor to attach the materials and/or supplies to the realty on a labor only or install only contract, or

c. The sale of materials and supplies is to an exempt entity which acts as the prime contractor by converting the tangible personal property to real property.

14. The sale of tangible personal property is not exempt from sales and use tax if the exempt entity is simply acting as the purchasing agent for the general contractor. It is not merely whether the exempt entity engages in the mechanics of a purchase, but rather the legal status of the exempt entity at the time the purchase is made, i.e., is it purchasing the property as the final consumer of the tangible personal property. If the exempt entity makes the purchase for itself and its own use, consumption, or conversion to real property, the purchase is exempt from sales and use tax. On the other hand, if the exempt entity makes the purchase for another person or entity, or for use, consumption, or conversion to real property by another person or entity, the purchase is not exempt from sales and use tax because the exempt entity has only acted in the capacity of a purchasing agent for the final consumer which is the contractor.

15. If the exempt entity enters into a furnish and install contract with a general or subcontractor which requires the general or subcontractor to furnish and install the materials and supplies, then the exempt entity is not acting as the prime contractor as to the materials and supplies required by contract to be provided by the general or subcontractor.

16. When the general or subcontractor is required by contract to provide materials and supplies and install them on real property, then the contractor is the consumer of that tangible personal property and is liable for the sales and use tax, even if an exempt entity goes through the mechanics of a purchase by issuing a purchase order and a check for payment. The contract is the controlling document, and determines who is the final consumer of tangible personal property, and thus the contract determines upon which party the incidence of taxation falls. Actions taken in noncompliance with the contract may be accepted without objection by the contractor and the exempt entity, but unless the contract is modified or changed by change order to show the consent of the contractor and the exempt entity to the modifications, the actions that are not in compliance with the contract do not shift or change the incidents of taxation. The written terms of the agreement will govern the taxability of the transaction and not the actions of the parties. This is especially so because written documents can be audited by State Tax Commission auditors, but actions, based on only after the fact statements, allegations or representations are impossible to audit.

17. For the exempt organization to be acting as the prime contractor, the exempt organization, by and through its own employees or agents must:

a. Exercise direct supervision over the construction project.

b. Issue purchase orders to the vendors for all materials and supplies for which sales tax is not paid.

c. Make direct payment to the vendors for all materials and supplies for which sales tax is not paid.

d. Have provisions in any furnish and install contracts to permit changes through change orders to make that portion of the contract a labor only or install only contract, and those contractual provisions must be fully implemented and followed during the construction process.

18. For the exempt organizations to act as the prime contractor exercising direct supervision over the construction project it is not necessary to act as the general contractor over the entire project. Instead, the exempt organization must exercise sufficient direct supervision over the purchased materials that there is a change in the legal status of which entity is responsible for those materials. Therefore, the exempt organization may be the prime contractor by exercising sufficient direct supervision over the purchased materials to be the prime contractor for a portion of the total contract.

The prime contractor or direct supervision requirement may apply to relationships within the full general contract.

19. To be the prime contractor and exercise sufficient direct supervision, the exempt organization must assume the "burdens of risk" or the "incidents of risk." This requires evidence that the exempt organization has done more than just act as a "purchasing agent" for the general contractor. If a general contractor issues a purchase order on forms of the exempt entity and then later issues authorization for payment by check to the exempt entity, there has just been the creation of a "paper trail" and the direct supervision test has not been met.

20. If the exempt organization and a general contractor enter into a furnish and install contract, the general contractor is contractually required to provide and install those materials. When the contractor provides and installs those materials the contractor is the final consumer of those materials and is required to pay sales or use tax on those materials (Rule R865-19-58S). For the exempt organization to purchase those materials and avoid sales or use tax, the furnish and install contract must contain a provision permitting change orders so the exempt organization may make such purchases, and the parties must then actually execute such change orders in advance of the purchases. The exempt organization, by its own employees or agents, must then issue purchase orders and vouchers or checks for payment, and must exercise direct supervision over the purchased materials. As

evidence regarding whether or not the exempt organization exercised direct supervision over the purchased materials, all of the relevant factors should be reviewed, including:

a. Who assumed the burdens or incidents of risk?

b. Who carried the risk of loss in the event of damage or destruction of the materials?

c. Who, if anyone, carried and paid for insurance on the materials after delivery and prior to installation or attachment to the real property?

d. Who physically inspected and counted the materials upon receipt?

e. If there was a shortage in materials upon receipt, who was required to pay for additional materials?

f. If there was an overage in materials upon receipt, who retained the surplus materials?

g. If the materials did not meet specifications or quality standards, who had the right and authority to reject those materials?

h. If materials were rejected for failure to meet quality standards or specifications, and it had resulted in a shutdown of the job, who would have been responsible for the shutdown expenses?

i. Who was responsible for enforcing any warranties on the materials?

j. To whom did recourse go if the materials were faulty or defective?

k. If materials failed after installation, who was responsible for any resulting damages including personal injuries?

l. To whom did the title pass for the purchased materials?

m. Were the bills submitted by the vendor directly to the exempt organization?

n. Did the vendors look only to the exempt organization for payment of the bill?

o. Did the general contractor or the subcontractor have to approve the bills before they were paid by the exempt organization?

p. To whom were the materials delivered, i.e., to the contractor, the exempt organization or one of its employees or agents, or directly to the job site?

21. Under a furnish and install contract, the contractor is required to furnish the materials and install those materials onto real property. Thus, the contractor is required to convert that tangible personal property into real property and the tax is imposed on that consumption of the tangible personal property by the contractor. Therefore, to avoid sales and use tax on materials used for a furnish and install contract, the contract must be modified through the

execution and implementation of change orders. When those change orders have been executed and implemented, the modified contract must make it clear that the materials in question have been separately purchased and provided by the exempt organization and that the contractor's only duty with respect to those materials is to provide the labor to install those materials.

22. For the purchases of materials and supplies to be exempt from sales and use tax, the exempt entity must make the purchase and, title to the purchased items must pass to the exempt entity prior to the time it is attached to real property. The exempt entity must deal with the purchased items as its own property and treat those items the same as it would treat items it purchases for its own use and consumption.

DECISION

Sales and Use Tax is imposed not only upon the sale of tangible personal property, but also upon "tangible personal property stored, used or consumed in this state." (U.C.A. 59-12-103[1]). In the construction business, when a person uses lumber, bricks, cement, steel, nails, and other materials to construct a building or other improvements to real estate, that person has used those materials and has converted the materials into real property. That conversion of tangible personal property into real property is deemed to be the consumption or use of the tangible personal property, which is the taxable event.

The Utah Supreme Court has consistently held that sales and use tax is imposed upon the party that converts

tangible personal property into real property. Utah Concrete Products Corp. v. State Tax Commission, supra, Olson Construction Co. v. State Tax Commission, supra, and Tummurru Trades, Inc. v. Utah State Tax Commission, supra. The party that makes that conversion from tangible personal property to real property has used or consumed that property, is the real property contractor, and is taxed on that property. If that conversion to real property is performed by anyone except an exempt entity, the use and consumption of the converted materials is subject to sales and use tax. If the conversion to real property is performed by an exempt entity acting as the real property contractor, the use and consumption of the converted materials is not subject to sales and use tax.

Therefore, the primary issue in this case is to determine whether the Petitioner was the real property contractor or whether the Utah Transit Authority, Granite School District or the Church of Jesus Christ of Latter Day Saints (LDS Church) was the real property contractor. If a preponderance of the evidence indicates that Petitioner was the party that converted the tangible personal property into real property, then Petitioner was the real property contractor and is liable for the tax assessed by the Auditing Division. However, if a preponderance of the evidence indicates that Utah Transit Authority, Granite School District, or the LDS Church, or any of them converted the tangible personal property into real property then they would be the real property contractor and would be exempt from the sales and use tax.

To determine which party was the real property contractor, it is necessary to review and analyze the full scope of the contract and the legal rights, duties, obligations, and relationships of the parties with respect to the materials converted into real property. The primary evidence available to the Commission to make that determination is the contracts and agreements, together with all duly executed change orders and other written documents. Oral testimony is beneficial in interpreting the documents and gaining some insight into the conduct of the parties and, to some extent, their understanding of the requirements of the contract. However, where any inconsistencies may exist between the written contract, including executed change orders, and either the conduct or oral testimony of any person, the written contract is normally presumed to govern or prevail.

Utah Transit Authority

In the portion of this proceeding involving the Utah Transit Authority, a preponderance of the evidence shows that the legal rights, duties and obligations of Utah Transit Authority raised to the level of the real property contractor because Utah Transit Authority assumed many of the burdens, risks, responsibilities and incidents of ownership of the materials being converted to real property. Utah Transit Authority hired Jacobsen Construction as the Construction Manager of the project, not as the general contractor. The contracts with Petitioner, ARCO Electric, and most of the other contractors and subcontractors were entered into directly by

the Utah Transit Authority. That contract between Petitioner and the Utah Transit Authority was for labor only, notwithstanding that the contract did contain a provision which stated that ARCO was to furnish supplies and materials. However, it is clear that there was no money included in the contract for materials or supplies. The contract was not a furnish and install contract. The original contract was for $279,756.00, which was all for labor to install the materials supplied by the Utah Transit Authority. Therefore, Utah Transit Authority was the prime contractor on the project, and Jacobsen Construction was an agent of Utah Transit Authority as stated in the contract. Since Utah Transit Authority was the prime contractor on the project, they converted the materials into real property and the incidents of taxation would be imposed on the Utah Transit Authority if it were not an entity that is exempt from taxation.

There are, however, three areas of concern. First, the invoices from General Electric were billed to ARCO Electric and not to Utah Transit Authority. Second, the contract did contain a provision requiring ARCO to provide the materials and supplies. Third, many of the purchase orders were not issued by Utah Transit Authority until after the materials and invoices had already been received. However, while these are areas of concern, there are reasonable explanations for each of them. The invoices from General Electric appears to be an error by General Electric. Invoices for materials from other companies were all billed directly to Utah Transit Authority. The provision in the contract for ARCO to provide materials and

supplies was not followed, and there was no money in the contract for materials or supplies and the issuance of purchase orders after the receipt of materials and invoices appears to be a shortfall caused by trust between the parties, and the time pressures of trying to get the job completed as rapidly as possible. In addition, because of the steps which were taken by Mr. Oswald, the attorney for Utah Transit Authority to try to assure compliance with the Tax Commission requirements, and the efforts of Utah Transit Authority to try to meet those requirements as they understood them, any doubts should be resolved in favor of the Utah Transit Authority.

In viewing the totality of the Utah Transit Authority project, Utah Transit Authority was the prime contractor, the real property contractor, and the party that converted the materials into real property. Utah Transit Authority purchased the materials used on that project and assumed most of the risks, burdens, responsibilities and incidents of ownership. Those materials were not purchased by Petitioner, and Petitioner did not assume the burdens, risks, responsibilities and incidents of ownership. Furthermore, the contract was really a labor only contract. Therefore, sales and use taxes for the Utah Transit Authority project should not be imposed on Petitioner.

In summary, it does appear that Utah Transit Authority assumed nearly all of the burdens, risks, responsibilities and incidents of ownership of those materials. Thus, a preponderance of the evidence indicates that Utah Transit Authority converted those materials from tangible personal

property into real property. Therefore, Utah Transit Authority was the real property contractor for those materials and pursuant to Rule R865-19-58S was exempt from the use tax on those materials.

Granite School District

In the portion of this proceeding involving Granite School District, a preponderance of the evidence shows that the legal rights, duties and obligations of the school district did not rise to the level of the real property contractor because the school district did not assume the burdens, risks, responsibilities and incidents of ownership of the materials being converted to real property. Except for the paper work involved in the purchase order and the check for payment, the school district had only minimal involvement in the project, including the materials, during the construction process. The general contractor and the subcontractors had nearly total control of and responsibility for the materials during the construction process.

There are numerous factors which show that Granite School District did not assume the burdens, risks, responsibilities and incidents of ownership. The price bid by Petitioner included all materials. The Petitioner negotiated and administered the direct purchases by the owner and furnished to the owner the source of supply and other information to enable the School District to purchase the materials. The risk of loss from damage, theft, vandalism or destruction of the materials was on the Petitioner after delivery of the materials. Storage of the materials was the

responsibility of Petitioner. The Petitioner was required to hold the owner harmless from any failure of the materials. The Petitioner was required to receive, inspect and sign for the materials upon delivery. The Petitioner could be held responsible for the loss of any prompt payment discounts or trade discounts, even though the School District was the party supposedly responsible for the payment. The construction bonds and insurance required from the Petitioner were not reduced to take away the responsibility for the materials purchased by the School District. The provisions for direct purchase by the School District did not relieve the Petitioner of any duties or obligations with respect to those materials. The invoices and requests for payment were made out in the name of the School District but were sent to the General Contractor for approval before the School District would make payment. The School District did not directly enter into the contract with Petitioner. Instead, Petitioner entered into its contract with the General Contractor.

All of the above factors show that the risks of ownership were never assumed by the School District, and those risks continued to be assumed by Petitioner. The primary involvement of the School District was in the paper work, or the creation of a paper trail. Except for the creation of that paper trail, the School District had only minimal physical contacts with the materials.

The school district did carry insurance on those materials, but the contractor was also required to carry insurance on those materials. The contractor and

subcontractors (including Petitioner) had all other burdens, risks, responsibilities and incidents of ownership on those materials. The Petitioner was contractually required to provide the materials for its portion of the project. Petitioner installed those materials onto the project, and acted as the owner of those materials by assuming the risks, burdens, responsibilities and incidents of ownership during the construction process. A preponderance of the evidence indicates that Petitioner converted those materials from tangible personal property into real property. Therefore, Petitioner was the real property contractor for those materials and pursuant to Rule R865-19-58S was liable for the use tax on those materials.

Church of Jesus Christ of Latter Day Saints

Print Center

In the portion of this proceeding involving the Church of Jesus Christ of Latter Day Saints Print Center, a preponderance of the evidence show that the legal rights, duties and obligations of the LDS Church did not rise to the level of the real property contractor because the LDS Church did not assume the burdens, risks, responsibilities and incidents of ownership of the materials being converted to real property. Except for the paper work involved in the purchase order and the check for payment, the LDS Church did not have substantial involvement in the project, or with the materials, during the construction process. The general contractor and the subcontractors had nearly total control of and

responsibility for the materials during the construction process.

There are also numerous factors which show the LDS Church did not assume the burdens, risks, responsibilities and incidents of ownership. The Church did not directly enter into the contract with Petitioner. Instead, Petitioner entered into its contract with the General Contractor. The price bid by Petitioner included all materials. The Petitioner was required to provide to the Church all of the necessary information, including the vendor and pricing, of where to purchase the materials. The risk of loss was on the Petitioner, and Petitioner was required to hold the Church harmless for the supplies or materials and from any loss, claim, defect, discrepancy, delay in delivery, or any other problem related to the supplies or materials. The Petitioner was responsible for the receipt, inspection, approval, storage and safe keeping of the materials. The construction bonds and insurance required from the Petitioner were not reduced to take away the responsibility for the materials purchased by the Church. The provisions for direct purchase by the Church did not relieve the Petitioner from the responsibility to fully comply with the contract, including providing the materials. The original purchase orders were prepared by the Petitioner. The Church would not pay for the materials until the Petitioner had approved the invoices for payment.

All of these factors show that the risks of ownership were never assumed by the Church, and those risks continued to be assumed by Petitioner. The primary involvement of the

Church was in the paper work, or the creation of a paper trail. Except for the creation of that paper trail, the Church had only minimal physical contacts with the materials.

The Church did employ a full time project representative who was on the project site on a full time basis, and part of his duties related to the materials purchased by the Church. The purchase orders and checks for payment were issued by the Church, and the furnish and install contract did contain provisions for change orders and change orders were executed.

However, the Commission must determine the case based upon a preponderance of the evidence. The Petitioner was contractually required to provide the materials for its portion of the project. Petitioner installed those materials onto the project, and acted as the owner of those materials by assuming the risks, burdens, responsibilities and incidents of ownership during the construction process. Therefore, a preponderance of the evidence indicates that Petitioner converted those materials from tangible personal property into real property. Therefore, Petitioner was the real property contractor for those materials and pursuant to Rule R865-19-58S was liable for the use tax on those materials.

ORDER

Based upon the foregoing, it is the order of the Utah State Tax Commission that the Petition for Redetermination for the Utah Transit Authority project is hereby granted, and the audit assessment made by the Auditing Division for that project is reversed and set aside.

The Petition for Redetermination for the Granite School District project and the Church of Jesus Christ of Latter Day Saints Print Center project is hereby denied, and the audit assessment made by the Auditing Division on those two projects is affirmed. It is so ordered.

DATED this 10th day of March, 1992.

BY ORDER OF THE UTAH STATE TAX COMMISSION.

R. H. Hansen
Chairman

Roger O. Tew
Commissioner

Joe B. Pacheco
Commissioner

S. Blaine Willes
Commissioner

NOTICE: You have twenty (20) days after the date of the final order to file a request for reconsideration or thirty (30) days after the date of final order to file in Supreme Court a petition for judicial review. Utah Code Ann. §§63-46b-13(1), 63-46b-14(2)(a).

GBD/wj/2723w

STATE TAX COMMISSION SEAL STATE OF UTAH

MAILING CERTIFICATE

I hereby certify that I mailed a copy of the foregoing Decision to the following:

Arco Electric
c/o Dudley M. Amoss
255 East 400 South, Suite 104
Salt Lake City, UT 84111

Utah Transit Authority
c/o Gayle F. McKeachnie
MCKEACHNIE & ALLRED
363 East Main Street
Vernal, Utah 84078

William Oswald
57 West 200 South, #500
Salt Lake City, Utah 84101

Granite School District
c/o Thomas Christensen, Jr.
FABIAN & CLENDENIN
215 South State Street, 12th Floor
P.O. Box 510210
Salt Lake City, Utah 84151

The Church of Jesus Christ of Latter Day Saints
c/o Graham Dodd
Robert P. Lunt
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1800 Eagle Gate Plaza
60 East South Temple
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DATED this 10th day of March, 1992.

Sara Jenson
Secretary

ADDENDUM C

(22) seasonal sales of crops, seedling plants, or garden, farm, or other agricultural produce if sold by the producer;

(23) purchases of food made with food stamps;

(24) any container, label, shipping case, or, in the case of meat or meat products, any casing;

(25) property stored in the state for resale;

(26) property brought into the state by a nonresident for his or her own personal use or enjoyment while within the state, except property purchased for use in Utah by a nonresident living and working in Utah at the time of purchase;

(27) property purchased for resale in this state, in the regular course of business, either in its original form or as an ingredient or component part of a manufactured or compounded product;

(28) property upon which a sales or use tax was paid to some other state, or one of its subdivisions, except that the state shall be paid any difference between the tax paid and the tax imposed by this part and Part 2, and no adjustment is allowed if the tax paid was greater than the tax imposed by this part and Part 2;

(29) any sale of a service described in Subsections 59-12-103(1)(b), (c), and (d) to a person for use in compounding a service taxable under the subsections;

(30) purchases of food made under the WIC program of the United States Department of Agriculture;

(31) sales or leases made after July 1, 1987, and before June 30, 1994, of rolls, rollers, refractory brick, electric motors, and other replacement parts used in the furnaces, mills, and ovens of a steel mill described in SIC Code 3312 of the 1987 Standard Industrial Classification Manual, of the federal Executive Office of the President, Office of Management and Budget, but only if the steel mill was a nonproducing Utah facility purchased and reopened for the production of steel;

(32) sales of boats of a type required to be registered under Title 73, Chapter 18, State Boating Act, boat trailers, and outboard motors which are made to bona fide nonresidents of this state and are not thereafter registered or used in this state except as necessary to transport them to the borders of this state;

(33) sales of tangible personal property to persons within this state that is subsequently shipped outside the state and incorporated pursuant to contract into and becomes a part of real property located outside of this state, except to the extent that the other state or political entity imposes a sales, use, gross receipts, or other similar transaction excise tax on it against which the other state or political entity allows a credit for taxes imposed by this chapter;

(34) sales of aircraft manufactured in Utah if sold for delivery and use outside Utah where a sales or use tax is not imposed, even if the title is passed in Utah; and

(35) until July 1, 1999, amounts paid for purchase of telephone service for purposes of providing telephone service.

History: L. 1933, ch. 63, § 6; 1933 (2nd S.S.), ch. 20, § 1; 1939, ch. 103, § 1; C. 1943, 80-15-6; 1945, ch. 110, § 1; 1957, ch. 126, § 1; 1957, ch. 127, § 1; 1965, ch. 128, § 1; 1967, ch. 162, § 1; 1969, ch. 187, § 3; 1969 (1st S.S.), ch. 14, § 3; 1973, ch. 42, § 9; 1973, ch. 154, § 1; 1975, ch. 179, § 2; 1976, ch. 28, § 1; 1979, ch. 195, § 1; 1981, ch. 238, § 1; 1981,

R865-19-42S. Sales to The State of Utah and Its Subdivisions Pursuant to Utah Code Ann. Section 59-12-104.

A. Sales made to the state of Utah, its departments and institutions or to its political subdivisions such as counties, municipalities, school districts, drainage districts, irrigation districts, and metropolitan water districts are exempt from tax if such property for use in the exercise of an essential governmental function. If the sale is paid for by a warrant drawn upon the state treasurer or the official disbursing agent of any political subdivision, the sale is considered as being made to the state of Utah or its political subdivisions and exempt from tax.

R865-19-58S. Materials and Supplies Sold to Owners, Contractors and Repairmen of Real Property Pursuant to Utah Code Ann. Sections 59-12-102 and 59-12-103.

A. Sale of tangible personal property to real property contractors and repairmen of real property is generally subject to tax.

1. The person who converts the personal property into real property is the consumer of the personal property since he is the last one to own it as personal property.

2. The contractor or repairman is the consumer of tangible personal property used to improve, alter or repair real property; regardless of the type of contract entered into—whether it is a lump sum, time and material, or a cost-plus contract.

3. The sale of real property is not subject to the tax nor is the labor performed on real property. For example, the sale of a completed home or building is not subject to the tax, but sales of materials and supplies to contractors and subcontractors are taxable transactions as sales to final consumers. This is true whether the contract is performed for an individual, a religious institution, or a governmental instrumentality.

4. Sales of materials to religious or charitable institutions and government agencies are exempt only if sold as tangible personal property and the seller does not install the material as an improvement to realty or use it to repair real property.

B. If the contractor or repairman purchases all materials and supplies from vendors who collect the Utah tax, no sales tax license is required unless the contractor makes direct sales of tangible personal property in addition to the work on real property.

1. If direct sales are made, the contractor shall obtain a sales tax license and collect tax on all sales of tangible personal property to final consumers.

2. The contractor must accrue and report tax on all merchandise bought tax-free and used in performing contracts to improve or repair real property. Books and records must be kept to account for both material sold and material consumed.

C. Sales of materials and supplies to contractors for use in out-of-state jobs are taxable unless sold in interstate commerce in accordance with Rule R865-19-44S.

D. This rule does not apply to contracts whereby the retailer sells and installs personal property which does not become part of the real property. See Rules R865-19-51S, R865-19-59S, and R865-19-78S for in-

ADDENDUM D

UTAH STATE TAX COMMISSION

160 East Third South
Salt Lake City, Utah 84134
Telephone (801) 530-6077
Fax (801) 530-6911

Clyde R. Nichols, Jr.
Executive Director

R. H. Hansen, Chairman
Roger O. Tew, Commissioner
Joe B. Pacheco, Commissioner
G. Blaine Davis, Commissioner

June 13, 1990

TO: All Petitioners Where The Issue Is Sales Tax On Construction Projects For Exempt Organizations.

The State Tax Commission issued a decision following a formal hearing in the matter of Horne Construction Corp. v. Audit Division of the State Tax Commission of Utah, Appeal No. 85-0118. This case involved sales tax on a construction project for a tax exempt organization. The decision was issued on November 25, 1987.

Since that time, there have been numerous questions raised regarding the interpretation of that decision and its impact on the other pending cases with a similar issue.

That decision contained several factors which made the conclusion inescapable that the transactions were not subject to sales and use tax. It is the understanding of the Commission that many of the pending cases do not contain all of the factors listed in the "Horne" decision, so legal counsel for several of the Petitioners have asked for further clarification and interpretation regarding which factors were controlling in that case.

Therefore, without attempting to pre-judge any of the pending cases, the Commission provides to the parties its interpretation of the "Horne" decision.

Section 59-12-104, U.C.A., provides in relevant part:

The following sales and uses are exempt from the taxes imposed by this chapter:

(2) sales to the state, its institutions, and its political subdivisions; . . . .

(8) sales made to or by religious or charitable institutions in the conduct of their regular religious or charitable functions and activities;

Rule R865-19-58S provides in relevant part:

A. Sale of tangible personal property to real property contractors and repairmen of real property is generally subject to tax.

3. . . . sales of materials and supplies to contractors and subcontractors are taxable transactions as sales to final consumers. This is true whether the contract is performed for an individual, a religious institution, or governmental instrumentality.

4. Sales of materials to religious or charitable institutions and government agencies are exempt only if sold as tangible personal property and the seller does not install the material as an improvement to realty or use it to repair real property.

In the "Horne" case, although Horne Construction was the major subcontractor for the exempt organization, it was held that the company was not liable for the sales and use tax because the exempt organization acted as the prime contractor and purchased their own materials and supplies. Those purchases by the exempt organization were not taxable. The key to that decision was that the exempt organization was acting as the contractor.

The next issue would be whether it would be necessary for all of the factors from the "Horne" case to be present for the Commission to deem other exempt organizations to also be acting as the contractor? The Commission is of the opinion that for an exempt organization to be acting as the contractor it must meet the following minimum criteria:

1. The exempt organization must exercise direct supervision over the construction project.

2. Purchase orders must be issued by the exempt organization for all materials for which sales tax is not paid.

3. Payment must be made by the exempt organization for all materials for which sales tax is not paid.

4. Any furnish and install contracts entered into must have provisions in the contract for changes through change orders.

The Commission desires to conclude the pending cases on this issue as rapidly as possible, either by stipulation between the parties or by appropriate hearings before the Commission. The Commission is well aware that there has been substantial delay in this matter which was not the fault of the Petitioners, and that penalties may have been imposed in matters where it was not clear that taxes were due on the transactions. Therefore, the Commission will waive all penalties and interest in these cases until 30 days after the date of this letter; i.e., no interest will be charged on any of the cases until 30 day after the date of this letter.

The Commission is scheduling a prehearing conference to inform the parties of these standards, to explore the possibility of consolidating the cases that are going forward to hearing, and to discuss any further procedural aspects of the cases. The prehearing conference will be scheduled at the same time for all petitioners in cases where it is known to the Commission that the issue is sales tax on construction projects for exempt organizations. It is not to discuss whether the Commission should have adopted some other interpretation of the "Horne" decision, whether particular fact situations comply with the above interpretation, or to discuss specific cases. Instead, it is intended to assist the parties in understanding the Commission's interpretation of the "Horne" decision.

This letter and a Notice of Prehearing Conference are being sent to all of the parties in cases where it is known that the issue in the case is sales and use tax on construction projects for tax exempt organizations. Because of limited space available for the hearing, it is requested that only one attorney or one other representative of each petitioner attend the prehearing conference.

R. H. Hansen
Chairman

Roger O. Tew
Commissioner

Joe B. Pacheco
Commissioner

G. Blaine Davis
Commissioner

ADDENDUM E

BEFORE THE UTAH STATE TAX COMMISSION

LAYTON CONSTRUCTION COMPANY, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	)	FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION Appeal No. 86-0650

STATEMENT OF CASE

This matter came before the Utah State Tax Commission for a formal hearing on June 13, 1991. Roger O. Tew, Commissioner, served as the Presiding Officer. In addition, R. H. Hansen, Chairman, Joe B. Pacheco, Commissioner, G. Blaine Davis, Commissioner, and Paul F. Iwasaki, Administrative Law Judge, heard the matter for and on behalf of the Commission. Present and representing the Petitioner were Bruce L. Olson, and Gerald T. Snow, Attorneys at Law, of Ray, Quinney and Nebeker, Eugene H. Bramhall, General counsel of Brigham Young University, and H. Hal Visick, Associate General Counsel of Brigham Young University. Present and representing the Respondent was Clark L. Snelson, Assistant Utah Attorney General.

Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. The tax in question is sales and use tax.

2. The period in question is January 1, 1982 to December 31, 1984.

3. Between January 1982 and December 1984, Petitioner was the general contractor for two projects on the campus of Brigham Young University (BYU) in Provo, Utah. Those two projects were the expansion of the BYU football stadium and the construction of the Technology Building.

4. BYU (the owner) is a religious and educational institution owned and operated by the Church of Jesus Christ of Latter Day Saints (LDS Church).

5. Prior to entering into contracts, BYU solicited potential bidders through its prequalification process, and requested that they submit furnish and install bids for each of the projects. Each of the submitted bids was required to contain a list of the materials to be used and the name of the supplier whose bid had been included in the final submitted bid.

6. BYU reserved the right to accept or reject any subcontractor or supplier listed by the general contractor in its bid and accept the next lowest subcontractor or supplier in the bid by paying the additional charges for the next lowest subcontractor or supplier.

7. BYU also reserved the right to purchase certain materials and furnish them to the general contractor by compliance with Section 75 of the contract conditions, which

provided that if BYU wanted to purchase a portion of the materials it would be handled as follows:

a. The owner and the contractor were required to mutually agree which materials the owner would purchase.

b. The cost of such materials, together with the amount the contractor would have paid as sales tax, would be deducted from the contract sum.

c. Upon agreement between the owner and the contractor as to which materials the owner was to purchase, the contractor was required to furnish to the owner all necessary information, including source of supply, to enable the owner to properly purchase such materials.

d. Contractor was required to hold the owner harmless from any failure of the supplies or materials so purchased if such failure resulted in any loss, claim, defect, discrepancy, delay in delivery or any other problem relating to the materials, except where the failure was directly caused by acts or omissions of the owner.

e. All bonds and insurance, required by the contract, had to remain in full force. There was no reduction in amount of coverage or any deduction for premiums for said bonds and insurance.

f. Materials ordered by the owner were not paid for until written approval had been given by the contractor.

g. The above conditions did not abrogate the contractor's responsibility to comply fully in the execution of the work as required by the contract.

8. Sections 22 and 75 of the contract conditions specifically permitted BYU to purchase materials and deduct the cost of such materials, plus the sales tax, by change orders from the contracts. However, even though the parties conducted their business as though the change orders were made, some of the change orders were never made by the parties. Thus, the parties were sometimes acting contrary to the contract, but the testimony represented that this was agreeable to both parties.

9. The contract provided that the general contractor was not the agent of BYU, but BYU could appoint the general contractor as the agent for BYU for such purposes as were decided by BYU and were agreeable to the general contractor. However, there is no evidence that BYU ever appointed the general contractor as its agent for any purpose.

10. The contract required BYU to appoint an "Owners Representative," to have supervisory responsibilities for the project. Fred A. Schwendiman, Director of BYU's Physical Plant Department was designated as the owners representative. Mr. Schwendiman was not on the projects on a day-to-day basis, but was represented by the manager of the Construction Section of the Physical Plant, Aldo C. Nelson, and one or more Construction Inspectors with the Construction Section.

11. The term "Owners Representative" was interpreted by BYU and Petitioner to mean Mr. Schwendiman, or the manager of the Construction Section of the Physical Plant Department, or any of the construction inspectors when they were on the job site. Pursuant to the contract, the owners representative had numerous responsibilities, including:

a. General supervision and direction of the work. He was the agent of the owner on the site.

b. Enforcing the performance of the contract, but not permitting any changes in the conditions of the contract.

c. Giving all instructions, directions, or other information to the contractor or his authorized agent.

d. The authority to stop the work whenever such stoppage was necessary to insure the proper execution of the contract. This included the stoppage of any work that was being improperly performed or using unacceptable materials, and he could demand that any incompetent workman be taken off the job and another person substituted.

e. To serve as interpreter of the conditions of the contract subject to the review of his decision or interpretations by the architect.

f. To serve as judge of the performance of the contract with power to enforce faithful performance subject to a review of his decision or interpretation by the architect.

g. To approve or reject the construction superintendent hired by the general contractor.

h. To approve the monthly progress estimate which was used as a basis for monthly progress payments to subcontractors.

i. Inspect and accept the finished project.

j. To approve or reject any proposed changes in the plans and specifications.

k. To withhold payment from the general contractor upon certain conditions.

12. The Manager of the Construction Section, Mr. Aldo C. Nelson, had the responsibility to coordinate, inspect and supervise all construction projects on the BYU Campus on behalf of the Director of Physical Plant, Fred A. Schwendiman. Mr. Nelson supervised a staff of inspectors who supervised on a daily basis all construction projects on the BYU Campus. Mr. Finn Murdoch was the inspector of both of the projects at issue in this proceeding.

13. The general contractor and subcontractors were responsible to furnish all materials provided in the specifications, other than those which BYU opted to purchase through change orders. The General contractor and subcontractors were required to pay sales taxes on all materials with the exception of those purchased by BYU pursuant to change order.

14. BYU excluded some materials for the projects from the contract. Petitioner was not required by the contract to purchase these materials. BYU purchased these materials directly, without using change orders or deducting the price of the materials and sales tax from the contract amounts. BYU did not pay sales tax on these items.

15. As to materials purchased for the projects by BYU, which Petitioner was required by the original contract to purchase, the following steps generally were taken by BYU, with the assistance of the general contractor:

a. BYU developed and printed a special purchase order form, called a "Z" purchase order.

b. BYU delegated the responsibility for preparing Z purchase orders to the general contractor, who in turn sometimes delegated that responsibility to the subcontractor. The Z purchase order identified the item(s) for purchase, quantity, supplier (from the bid documents) and other data. Each Z purchase order also showed that BYU was the ordering and purchasing party and that the materials should be delivered to the construction project on the BYU campus. In the case of steel for the stadium expansion, the Z purchase orders reflected that invoices should be sent to BYU, in care of the subcontractor, Allen Steel Company, and that the steel should be delivered to Allen's yard in Salt Lake City, in the name of the Cougar Stadium Project, in order to perform fabrication on the steel prior to delivery to the BYU campus.

c. After being filled in by the general contractor and/or subcontractor, the Z purchase order was reviewed by BYU Construction Section officials and logged in on a master list.

d. BYU seldom objected to the manner in which the general contractor completed Z purchase orders or the suppliers listed in bid documents, due to communication between BYU and the general contractor, the information provided by BYU and the general contractor at the bid stage, and the trust BYU and the general contractor have developed over many years.

e. After being reviewed by the BYU Construction Section, the Z purchase order was then sent to the BYU Purchasing Department, which in turn submitted it to the supplier for processing.

f. Generally, materials were shipped to the campus construction sites, where they were received and inspected for quantity and quality by the general contractor and/or subcontractors. In most cases, BYU Construction Section personnel also inspected the materials at the same time. In some cases, such as with the BYU-purchased steel on the stadium expansion, the materials were first delivered to a location other than to the BYU campus and were inspected by BYU personnel there.

g. Steel for the stadium expansion was delivered to the yard of Allen Steel Company, the steel subcontractor, for further fabrication. BYU arranged for U.S. Steel Corporation and its Geneva Works to test the manufactured steel and provide written reports to BYU as to the test results. BYU also hired Pittsburg Testing Laboratory, a professional consulting firm, to analyze and test the steel at BYU's expense over a period of many months. The consultants checked, both manually and through ultrasonic and x-ray devices, welds, fabrication, length, thickness, compliance with drawings, painting and bolt torque. During peak periods of steel delivery, the consultants had teams working 24 hours per day. The consultant rejected some of the fabricated steel, and BYU then required the manufacturer, its agents and/or the subcontractor to remedy all defects or problems discovered with the steel.

h. The contract did require the general contractor to be responsible to resolve problems with the suppliers of materials purchased through Z purchase orders,

such as delays, damage in transit, and poor handling, but BYU did take care of most of the problems that occurred.

i. The general contractor inspected and accounted for the materials at the construction site to ensure that materials were not wasted and that completion of the overall project was not delayed.

j. Once materials were received, a bill was delivered to BYU. Upon receiving word from Nelson or Murdoch and from the general contractor that the correct quantity and quality of materials had been received, the BYU Purchasing Department paid the bill with a BYU check.

k. If BYU overpaid a vendor (e.g., due to an accounting error), it was BYU's responsibility to correct the error and obtain a refund. BYU did not receive a credit against the contract bid for the overpayment.

l. Because of their significant buying power, the LDS Church and/or BYU were able to obtain discounts upon purchasing certain supplies and materials. Any price discounts given to BYU when purchasing materials were kept by BYU and not passed on to the general contractor.

16. The cost (as reflected in the bid) of the materials purchased through Z purchase orders, in addition to the amount of sales tax attributable thereto, was to be deducted from the contract bid by change orders. However, while the parties executed some change orders, such change orders were not executed for all materials purchased by BYU. BYU and Petitioner both testified that they did not feel that

change orders were always necessary because of their long history of dealing with each other.

17. On materials purchased through Z purchase orders, BYU paid 100% of the purchase price of materials, once the materials were inspected and found to be in order. However, BYU paid only 90% of the purchase price of materials purchased by the general contractor, holding back a 10% retainage. This retainage largely comprised the general contractor's profit and provided a safety net for BYU that the general contractor would fully perform on the contract. With respect to materials paid for by BYU, the 10% retainage was not available to BYU.

18. BYU sent release forms to suppliers who sold materials to BYU, to ensure that no further claim would be made against Z purchase orders.

19. If a subcontractor failed to pay a supplier, the general contractor bore the risk of liens on the project through the 10% contract retainage. The general contractor did not bear this risk with respect to the materials purchased and paid for by BYU.

20. BYU relied upon the general contractor to ensure that BYU-purchased materials were not lost, misplaced or damaged after arrival at the construction sites and prior to installation by the general contractor or subcontractors. BYU also took an active part in providing security for BYU-purchased materials by providing general security for the construction sites through its Security Police officials, and also provided fencing materials to the general contractor,

which were installed around all construction materials and equipment located at the Projects.

21. BYU was required to and did provide a Builder's Risk Insurance Policy for each of the projects. That coverage was furnished and paid for by the Church of Jesus Christ of Latter-day Saints. This insurance policy covered the materials for all physical losses and damage from the time of arrival at the construction sites through installation of the materials.

22. The risk of damage or loss of materials purchased by BYU was the responsibility of BYU or its insurer, until delivery was made to the job sites. The risk of loss for materials purchased by BYU after the materials arrived at the job sites was covered by the Builder's Risk Insurance Policy. BYU further relied upon the Petitioner to prevent loss, damage or theft of BYU-purchased materials.

23. Suppliers looked to BYU for payment, and it was BYU who paid them, promptly and in full, assuming the suppliers delivered the materials as and when requested.

24. Warranty Certificates provided by vendors were made in the name of BYU and not in the name of the general contractor or subcontractors.

25. There have been no claims made against suppliers of materials pursuant to warranties on those materials because there have been no failures of the materials. BYU was the owner of surplus materials which remained following completion of the projects. BYU takes possession and uses excess materials it has purchased after all construction projects on its campus. No materials purchased by BYU for the projects

were retained by the general contractor or subcontractors following completion of the projects.

CONCLUSIONS OF LAW

1. Sales made to the state, its institutions, and its political subdivisions are exempt from sales and use taxes. (Utah Code Ann. §59-12-104(2).)

2. Sales made to or by religious or charitable institutions in the conduct of their regular religious or charitable functions and activities are exempt from sales and use taxes. (Utah Code Ann. §59-12-104(8).)

3. Sales of tangible personal property to real property contractors and repairmen of real property are subject to sales and use taxes. (Rule R865-19-58S).

4. The person who converts personal property into real property is the consumer of the personal property since he or she is the last person to own it as personal property. (Rule R865-19-58S). Utah Concrete Products Corp. v. State Tax Commission, 802 P.2d 408 (Utah 1942); Olson Construction Company v. State Tax Commission, 12 Utah 2d 42, 361 P.2d 1112 (Utah 1961); and Tummurru Trades, Inc. v. Utah State Tax Commission, 802 P.2d 715 (Utah 1990).

5. The contractor or repairman is the consumer of tangible personal property used to improve, alter or repair real property. (Rule R865-19-58S).

6. Sales of materials and supplies to contractors and subcontractors are taxable transactions as sales to final consumers, even if the contract is performed for a religious

institution, charitable organization, or governmental instrumentality. (Rule R865-19-58S).

7. Sales of materials to religious institutions, charitable organizations, and governmental instrumentalities are exempt only if sold as tangible personal property and the direct or indirect seller does not install the material as an improvement to realty or use it to repair real property. (Rule R865-19-58S).

8. The contractor must accrue and report tax on all merchandise bought tax-free and used in performing contracts to improve or repair real property. (Rule R865-19-58S).

9. Rule R865-19-58S is the primary rule governing the sale of materials and supplies sold to owners, contractors and repairmen of real property, and it sets forth the requirements for the taxation of the sale or acquisition of tangible personal property which is to be used to improve, alter or repair real property. That rule provides in relevant part:

> A. Sale of tangible personal property to real property contractors and repairmen of real property is generally subject to tax.
>
> 1. The person who converts the personal property into real property is the consumer of the personal property since he is the last one to own it as personal property.
>
> 2. The contractor or repairman is the consumer of tangible personal property used to improve, alter or repair real property; regardless of the type of contract entered into--whether it is a lump sum, time and material, or a cost-plus contract.

> 3. The sale of real property is not subject to the tax nor is the labor performed on real property. For example, the sale of a completed home or building is not subject to the tax, but sales of materials and supplies to contractors and subcontractors are taxable transactions as sales to final consumers. This is true whether the contract is performed for an individual, a religious institution, or a governmental instrumentality.
>
> 4. Sales of materials to religious or charitable institutions and government agencies are exempt only if sold as tangible personal property and the seller does not install the material as an improvement to realty or use it to repair real property.

10. Sales of materials from a vendor to a contractor or other person or entity for use in the construction, improvement, alteration or repair of real property for a governmental entity, religious institution or charitable organization is not exempt from sales and use tax. The incidents of the tax have been imposed on the contractor and not on the exempt entity. To be exempt, the sale must be from the vendor directly to the governmental entity, religious institution or charitable organization for the use of, and consumption by, the exempt entity.

11. The fact that the burden of the tax may be passed by the contractor on to the exempt entity in the form of higher prices and is thus paid indirectly by the exempt entity does not result in tax exemption for the transaction. (Rule R865-19-58S), Utah Concrete Products Corp. v. State Tax Commission, 101 Utah 513, 125 P.2d 408 (1942), and Ford J. Twaits Co. v. Utah State Tax Commission, 106 Utah 343, 148 P.2d

343 (1944), Olsen Construction Company v. State Tax Commission, 12 U.2d 42, 361 P.2d 1112 (1961).

12. Parties seeking exemptions from the imposition of that tax bear the burden of proving that they qualify and are legally entitled to the exemption. Parson Asphalt Products v. Utah State Tax Commission, 617 P.2d 397 (1980).

13. In order for the sale to the exempt entity to be exempt from sales and use tax it must be a bona fide sale to the exempt entity acting either in the capacity as the final consumer of tangible personal property or the entity which converts the tangible personal property to real property. The sale is such a bona fide sale to an exempt entity only if either:

a. The sale of materials or supplies is to the exempt entity and the exempt entity has its own employees attach the materials and/or supplies to the realty, or

b. The sale of materials and supplies is to the exempt entity, and the exempt entity separately hires a contractor to attach the materials and/or supplies to the realty on a labor only or install only contract, or

c. The sale of materials and supplies is to an exempt entity which acts as the prime contractor by converting the tangible personal property to real property.

14. The sale of tangible personal property is not exempt from sales and use tax if the exempt entity is simply acting as the purchasing agent for the general contractor. It is not

merely whether the exempt entity engages in the mechanics of a purchase, but rather the legal status of the exempt entity at the time the purchase is made, i.e., is it purchasing the property as the final consumer of the tangible personal property. If the exempt entity makes the purchase for itself and its own use, consumption, or conversion to real property, the purchase is exempt from sales and use tax. On the other hand, if the exempt entity makes the purchase for another person or entity, or for use, consumption, or conversion to real property by another person or entity, the purchase is not exempt from sales and use tax because the exempt entity has only acted in the capacity of a purchasing agent for the final consumer, which is the contractor.

15. If the exempt entity enters into a furnish and install contract with a general or subcontractor which requires the general or subcontractor to furnish and install the materials and supplies, then the exempt entity is not acting as the prime contractor as to the materials and supplies required by contract to be provided by the general or subcontractor.

16. When the general or subcontractor is required by contract to provide materials and supplies and install them on real property, then the contractor is the consumer of that tangible personal property and is liable for the sales and use tax, even if an exempt entity goes through the mechanics of a purchase by issuing a purchase order and a check for payment. The contract is the controlling document, and determines who is the final consumer of tangible personal property, and thus the contract determines upon which party the incidence of taxation

falls. Actions taken in noncompliance with the contract may be accepted without objection by the contractor and the exempt entity, but unless the contract is modified or changed by change order to show the consent of the contractor and the exempt entity to the modifications, the actions that are not in compliance with the contract do not shift or change the incidents of taxation. The written terms of the agreement will govern the taxability of the transaction and not the actions of the parties. This is especially so because written documents can be audited by State Tax Commission auditors, but actions, based on only after the fact statements, allegations or representations are impossible to audit.

17. For the exempt organization to be acting as the prime contractor, the exempt organization, by and through its own employees or agents must:

a. Exercise direct supervision over the construction project.

b. Issue purchase orders to the vendors for all materials and supplies for which sales tax is not paid.

c. Make direct payment to the vendors for all materials and supplies for which sales tax is not paid.

d. Have provisions in any furnish and install contracts to permit changes through change orders to make that portion of the contract a labor only or install only contract, and those contractual provisions must be fully implemented and followed during the construction process.

18. For the exempt organizations to act as the prime contractor exercising direct supervision over the construction project it is not necessary to act as the general contractor over the entire project. Instead, the exempt organization must exercise sufficient direct supervision over the purchased materials that there is a change in the legal status of which entity is responsible for those materials. Therefore, the exempt organization may be the prime contractor by exercising sufficient direct supervision over the purchased materials to be the prime contractor for a portion of the total contract. The prime contractor or direct supervision requirement may apply to relationships within the full general contract.

19. To be the prime contractor and exercise sufficient direct supervision, the exempt organization must assume the "burdens of risk" or the "incidents of risk." This requires evidence that the exempt organization has done more than just act as a "purchasing agent" for the general contractor. If a general contractor issues a purchase order on forms of the exempt entity and then later issues authorization for payment by check to the exempt entity, that action would be considered as the creation of a "paper trail" and the direct supervision test has not been met.

20. If the exempt organization and a general contractor enter into a furnish and install contract, the general contractor is contractually required to provide and install those materials. When the contractor provides and installs those materials the contractor is the final consumer of those

materials and is required to pay sales or use tax on those materials (Rule R865-19-58S). For the exempt organization to purchase those materials and avoid sales or use tax, the furnish and install contract must contain a provision permitting change orders so the exempt organization may make such purchases, and the parties must then actually execute such change orders in advance of the purchases. The exempt organization, by its own employees or agents, must then issue purchase orders and vouchers or checks for payment, and must exercise direct supervision over the purchased materials. As evidence regarding whether or not the exempt organization exercised direct supervision over the purchased materials, all of the relevant factors should be reviewed, including:

a. Who assumed the burdens or incidents of risk?

b. Who carried the risk of loss in the event of damage or destruction of the materials?

c. Who, if anyone, carried and paid for insurance on the materials after delivery and prior to installation or attachment to the real property?

d. Who physically inspected and counted the materials upon receipt?

e. If there was a shortage in materials upon receipt, who was required to pay for additional materials?

f. If there was an overage in materials upon receipt, who retained the surplus materials?

g. If the materials did not meet specifications or quality standards, who had the right and authority to reject those materials?

h. If materials were rejected for failure to meet quality standards or specifications, and it had resulted in a shutdown of the job, who would have been responsible for the shutdown expenses?

i. Who was responsible for enforcing any warranties on the materials?

j. To whom did recourse go if the materials were faulty or defective?

k. If materials failed after installation, who was responsible for any resulting damages including personal injuries?

l. To whom did the title pass for the purchased materials?

m. Were the bills submitted by the vendor directly to the exempt organization?

n. Did the vendors look only to the exempt organization for payment of the bill?

o. Did the general contractor or the subcontractor have to approve the bills before they were paid by the exempt organization?

p. To whom were the materials delivered, i.e., to the contractor, the exempt organization or one of its employees or agents, or directly to the job site?

21. Under a furnish and install contract, the contractor is required to furnish the materials and install those materials onto real property. Thus, the contractor is required to convert that tangible personal property into real property and the tax is imposed on that consumption of the tangible personal property by the contractor. Therefore, to avoid sales and use tax on materials used for a furnish and install contract, the contract must be modified through the execution and implementation of change orders. When those change orders have been executed and implemented, the modified contract must make it clear that the materials in question have been separately purchased and provided by the exempt organization and that the contractor's only duty with respect to those materials is to provide the labor to install those materials.

22. For the purchases of materials and supplies to be exempt from sales and use tax, the exempt entity must make the purchase and title to the purchased items must pass to the exempt entity prior to the time it is attached to real property. The exempt entity must deal with the purchased items as its own property and treat those items the same as it would treat items it purchases for its own use and consumption.

DECISION AND ORDER

Sales and Use Tax is imposed not only upon the sale of tangible personal property, but also upon "tangible personal property stored, used or consumed in this state." (U.C.A. 59-12-103[1]). In the construction business, when a person uses lumber, bricks, cement, steel, nails, and other materials to construct a building or other improvements to real estate,

that person has used those materials and has converted the materials into real property. That conversion of tangible personal property into real property is deemed to be the consumption or use of the tangible personal property, which is the taxable event.

The Utah Supreme Court has consistently held that sales and use tax is imposed upon the party that converts tangible personal property into real property. Utah Concrete Products Corp. v. State Tax Commission, supra, Olson Construction Co. v. State Tax Commission, supra, and Tummurru Trades, Inc. v. Utah State Tax Commission, supra. The party that makes that conversion from tangible personal property to real property has used or consumed that property, is the real property contractor, and is taxed on that property. If that conversion to real property is performed by anyone except an exempt entity, the use and consumption of the converted materials is subject to sales and use tax. If the conversion to real property is performed by an exempt entity acting as the real property contractor, the use and consumption of the converted materials is not subject to sales and use tax.

Therefore, the primary issue in this case is to determine whether the Petitioner or BYU was the real property contractor. If a preponderance of the evidence indicates that Petitioner was the party that converted the tangible personal property into real property, then Petitioner was the real property contractor and is liable for the tax assessed by the Auditing Division. However, if a preponderance of the evidence

indicates that BYU was the party that converted the tangible personal property into real property then BYU was the real property contractor and was exempt from the sales and use tax.

To determine which party was the real property contractor, it is necessary to review and analyze the full scope of the contract and the legal rights, duties, obligations, and relationships of the parties with respect to the materials converted into real property. The primary evidence available to the Commission to make that determination is the contract and agreement, together with all duly executed change orders and other written documents. Oral testimony is beneficial in interpreting the documents and gaining some insight into the conduct of the parties and, to some extent, their understanding of the requirements of the contract. However, where any inconsistencies may exist between the written contract, including executed change orders, and either the conduct or oral testimony of any person, the written contract is normally presumed to govern or prevail.

In this proceeding, a preponderance of the evidence shows that the legal rights, duties and obligations of BYU raised BYU to the level of the real property contractor because BYU assumed sufficient burdens, risks, responsibilities and incidents of ownership of the materials being converted to real property. BYU created a special purchase order form to be used only to purchase tax exempt materials for use in construction projects, and BYU issued those purchase orders. BYU paid for those purchases with its own checks. BYU had its own

supervisory personnel who had substantial responsibilities with respect to the materials. They were required to inspect and approve the materials for both quantity and quality. Those supervisors had general supervisory responsibility on the job and had the right to give instructions and directions to the contractor, and even the authority to stop work on the projects if the work was not being properly performed or if the materials being used were unacceptable. They had authority to approve or reject the construction superintendent hired by the general contractor, and even the right to withhold payments from the general contractor under certain conditions.

Once the materials were received, BYU participated in the storage of the materials by providing fencing and having its campus security police patrol the area to help prevent theft and damage. BYU sometimes negotiated reduced prices or price discounts on the materials which resulted in prices that were lower than the price which had been bid to the general contractor, and BYU benefited from the reduced prices. BYU did not deduct a retainage on the materials which it purchased, whereas it deducted a 10% retainage on materials provided by Petitioner. If BYU overpaid any invoices, they could not deduct the overpayments from the amounts due to Petitioner, but obtained its own refunds from the suppliers. BYU retained all excess materials and pursued all warranties on the materials. BYU hired independent inspectors to review and assure the quality of the steel and some other materials, and they carried the insurance on the materials. In summary, it does appear that BYU assumed nearly all of the burdens, risks,

responsibilities and incidents of ownership of those materials. Thus, a preponderance of the evidence indicates that BYU converted those materials from tangible personal property into real property. Therefore, BYU was the real property contractor for those materials and pursuant to Rule R865-19-58S was exempt from the sales and use tax on those materials.

In this proceeding, the primary area of concern to the Commission is the non-adherence to the contract between the parties. That contract between BYU and Petitioner required Petitioner to provide the materials and install the materials on the projects. Change orders were permitted by the contract, and change orders were prepared and executed on some, but not all, of the materials purchased by BYU. Under the rules of the Commission and the Conclusions of Law stated above, the materials on which change orders were not prepared or executed would be purchases of Petitioner and Petitioner would have consumed the materials when they were converted to real property, and therefore, Petitioner would be responsible for the tax on those materials.

Petitioners position on that issue is that Petitioner and BYU had a very unique relationship, and because of their course of dealing for more than twenty years there was a unique trust and respect between them. BYU has concurred with those representations of the Petitioner. Both BYU and Petitioner testified that it was their intent for BYU to purchase the materials in question and to assume most of the risks with

respect to those materials. They further testified that even on those materials on which change orders were not prepared or executed, the conduct of the parties by BYU purchasing and providing the materials demonstrated their contractual intent, and mutual consent to modify the contract by their performance even though changes were not made in the written documentation. The testimony of the parties is supported by their conduct. BYU did assume the burdens, risks and responsibilities for the materials even though they were not contractually required to do so because the change orders had not been executed.

The Commission has some reservations about those arguments, but because the conduct of the parties supports their testimony, in the absence of clarity in the rules that the written contract will prevail over the conduct or actions of the parties, the Commission is inclined to accept that position for retroactive, but not prospective, interpretation of the construction contracts for these projects. There is other substantial evidence to indicate that BYU did in fact buy the materials and assumed most of the burdens, risks, responsibilities, and incidents of ownership.

Based upon the foregoing, it is the order of the Utah State Tax Commission that the Petition for Redetermination is hereby granted and the audit assessment made by the Auditing Division is reversed and set aside. It is so ordered.

DATED this 9th day of March, 1992.

BY ORDER OF THE UTAH STATE TAX COMMISSION.

R. H. Hansen
Chairman

Roger O. Tew
Commissioner

Joe B. Pacheco
Commissioner

S. Blaine Willes*
Commissioner

NOTICE: You have twenty (20) days after the date of the final order to file a request for reconsideration or thirty (30) days after the date of final order to file in Supreme Court a petition for judicial review. Utah Code Ann. §§63-46b-13(1), 63-46b-14(2)(a).

*Since the hearing on this case, Commissioner G. Blaine Davis has been replaced by S. Blaine Willes. Commissioner Willes has been duly advised of the facts and circumstances regarding this case, and is qualified to sign this decision.

GBD/wj/2679w

STATE TAX COMMISSION SEAL STATE OF UTAH

MAILING CERTIFICATE

I hereby certify that I mailed a copy of the foregoing Decision to the following:

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DATED this 9th day of March 1992.

Sara Jenson
Secretary